EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2000 (FINANCIAL SERVICES COMPENSATION SCHEME) ORDER 2013

2013 No. [XXXX]

1. This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This instrument allocates rulemaking responsibility for the Financial Services Compensation Scheme between the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA), broadly reflecting the overall split in their regulatory responsibilities in the financial services sector. The PRA may or may not make compensation rules for deposit takers and insurers and the FCA may or may not make compensation rules for all other types of financial activity.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 This instrument is required under the Financial Services Act 2012, which received Royal Assent on 19 December 2012, in advance of the new regulatory system for financial services in the UK being implemented on 1 April 2013. Paragraph 3 of Schedule 10 to the Financial Services Act 2012 amends section 213 of the Financial Services and Markets Act 2000. Section 213(1A) requires the Treasury to specify by order the cases in which the PCA and the FCA must make compensation scheme rules.

4.2 Broadly this SI reflects the split in regulatory responsibility between the PRA and FCA as provided for in the Order made under s22A of the Financial Services and Markets Act 2000, as amended by the Financial Services Act 2012.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Financial Secretary to the Treasury has made the following statement regarding Human Rights:

In my view the provisions of the Financial Services and Markets Act 2000 (Financial Services Compensation Scheme) Order 2013 are compatible with the Convention rights.

7. Policy background

7.1 The Financial Services Act 2012 provides for the reform of financial regulation in the UK. In the place of the Financial Services Authority (FSA), it establishes a new system of financial services regulators comprising:

- An expert macro-prudential authority, the Financial Policy Committee (FPC) within the Bank of England to monitor and respond to systemic risks in the financial sector;
- A focused micro-prudential regulator, the Prudential Regulation Authority (PRA), to regulate firms that manage complex risks on their balance sheets - specifically, all deposit takers, insurers and some large investment firms; and
- A focused conduct of business regulator, the Financial Conduct Authority (FCA), to ensure that business across financial services and markets is conducted in a way that advances the interests of all users and participants.

7.2 The Financial Services Compensation Scheme (FSCS) is the UK's compensation fund of last resort for customers of authorised financial services firms. As the provision of compensation is essential to both supporting consumer confidence and promoting stability, the role of the FSCS will interact with both the FCA and the PRA in the new regulatory system. Recognising the value of a single compensation scheme to aid consumers, the Government is therefore implementing a model where the FCA and PRA will have joint oversight of the FSCS, but split rulemaking responsibilities that reflect the general division of regulatory responsibilities between the two new regulators. Although the PRA and the FCA are required to make rules to establish a scheme for compensating persons where relevant persons or successors are unable, or likely to be unable to satisfy claims against them, neither the PRA nor the FCA is obliged by this Order to make rules for all the types of claim set out in Articles 2 and 3.

7.3 The Order also provides that the PRA may make compensation rules for claims arising in respect of the regulated activities of managing the underwriting capacity of a Lloyd’s syndicate as a managing agent at Lloyd’s; or arranging deals in contracts of insurance written at Lloyd’s – both of which are also PRA-regulated activities. The FSA has not made any compensation rules for those activities in the past and it is not anticipated that the PRA will do so.

8. Consultation outcome

8.1 The instrument was subject to full public consultation in the document "A new approach to financial regulation: draft secondary legislation", which was published on the HM Treasury website on 15 October. The consultation closed on 24 December, in line with Government guidance on public consultation.

8.2 Very few respondents to the consultation exercise commented on the drafting of the instrument. Those that did agreed that the drafting achieved the stated policy aim of allocating FSCS rulemaking responsibility between the PRA and FCA. As a result, the instrument has not been altered from the draft that was consulted upon (except for minor drafting changes). Some respondents also took the opportunity to raise specific issues with how the FSCS is funded. The Government believes that the funding model of the FSCS is best determined by expert regulators, who can take a view on affordability and likelihood of firm failure in specific classes of firms. Accordingly the Government believes that it is not appropriate to make restrictions on how the FSCS should be funded in secondary legislation.

8.3 The Government's overall proposals for how the FSCS will function in the new regulatory system have also been subject to three previous consultation exercises and have been broadly supported by the majority of respondents who commented on them.

9. Guidance

9.1 Further guidance on how the new regulators will fulfil their responsibilities in relation to the FSCS will be made available by the PRA and FCA.

10. Impact

10.1 The instrument, in itself, does not impose any additional regulatory burdens on business, charities or voluntary bodies. The impact of the overall change to the regulatory system on business, charities or voluntary bodies, in so far as they are regulated financial services firms, is set out in the overarching impact assessment for the Financial Services Act 2012.

10.2 The impact on the public sector is set out in the overarching impact assessment for the Financial Services Act 2012.

10.3 An Impact Assessment has not been prepared for this instrument. Instead the overarching Impact Assessment that covers the changes to the regulatory system provided for by the Financial Services Act 2012 is available on the Treasury website as Annex H to the following publication: http://www.hm-treasury.gov.uk./d/condoc_fin_regulation_draft_secondary_leg.pdf.

11. Regulating small business

11.1 The legislation applies to small business, but does not in itself impose any additional regulatory requirements on them.

11.2 To minimise the impact of the requirements on firms employing up to 20 people, the PRA and FCA will be required by the Financial Services Act 2012 to 'have regard' to the principle of proportionality when carrying out their general functions through section 3B of the Financial Services and Markets Act 2000; specifically, that any burdens they impose should be proportionate to the benefits that are expected to result. Additionally, the PRA and FCA will be required to carry out and publish cost benefit analyses on any new requirements they impose.

11.3 The basis for the final decision on what action to take to assist small business was that this instrument will not impose additional burdens on small businesses.

12. Monitoring & review

12.1 HM Treasury will monitor the practical effects of this instrument to ensure it continues to meet the policy aims.

13. Contact

Chris Goodspeed at HM Treasury Tel: 0207 270 5690 or email: christopher.goodspeed@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.