EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2000 (PRA-REGULATED ACTIVITIES) 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 divides responsibility for prudential regulation of authorised persons (within the meaning of the Financial Services and Markets Act 2000) between the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). The instrument provides that deposit taking, effecting and carrying on contracts of insurance and certain activities in relation to the Lloyd's market are to be prudentially regulated by the PRA. In addition, the Order specifies that dealing in investments as principal is to be prudentially regulated by the PRA when carried on by a person who is designated under this Order by the PRA. The Order (articles 10 and 11) also makes provision for transitional arrangements to cater for the scenario where, in the future, the PRA decides to give a designation or to revoke a designation under this Order and as a result the identify of the prudential regulator of an authorised person changes[1].

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

3.1 None.

4. Legislative Context

4.1 This instrument is made under section 22A of the Financial Services and Markets Act 2000 as amended by the Financial Services Act 2012. This order will support the new regulatory system for financial services in the UK provided for in the 2012 Act.

4.2 This instrument refers to the activities specified by the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544) which specifies what

[1] The identify of the prudential regulator of authorised persons who are currently prudentially regulated by the Financial Services Authority may change on 1 April 2013, when the new regulatory regime provided for by the Financial Services Act 2012 is expected to come fully into force; some authorised persons will become prudentially regulated by the PRA. Transitional provisions for that transition are being made separately under section 119 of that Act. This Order makes transitional provision for subsequent changes in the identity of an authorised person's prudential regulator by virtue of the exercise by the PRA of its designation power under this Order.

activities are “regulated activities” for the purposes of the Financial Services and Markets Act 2000.

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 (PRA-regulated Activities) 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 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 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 scope of firms that require expert micro-prudential regulation and supervision by the PRA may change over time; for example, as a result of international discussions on financial reform, or in response to innovation in the financial sector. The FPC will be responsible for monitoring the perimeter of prudential regulation, and it will be able to make recommendations to the Treasury about changes to the scope of regulation by the PRA or the FCA, in pursuit of its objective. In order to provide the necessary flexibility to allow the regulatory system to respond to such future changes, the scope of activities regulated by the PRA will be set out in secondary legislation.

7.3 The instrument provides that deposit taking, effecting and carrying on contracts of insurance and certain activities in relation to the Lloyd’s market are to be prudentially regulated by the PRA.

7.4 The order also provides that certain investment firms (that is those who deal in investments as principal) may be subject to prudential regulation by the PRA, if the PRA

designates the firm for this purpose. The PRA may designate an investment firm where the PRA determines that it is desirable, in light of the PRA's objectives, for the PRA to regulate prudentially that firm. This may be appropriate where the scale or complexity of such a firm's operations and its interconnectedness with other firms or the system as a whole give rise to a risk to the stability of the financial system or the safety and soundness of one or more PRA-authorised persons within their group. It is expected that a minority of investment firms will be designated by the PRA: most will be prudentially regulated by the FCA.

8. Consultation outcome

8.1 The order 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 included a draft of this Order. The consultation closed on 24 December, in line with Government guidance on public consultation.

8.2 Most consultation respondents did not comment in detail on the section 22A order. Some respondents stated their view that firms should be allowed sufficient time (for example, 12 months) to make any necessary adjustments to enable it to meet the PRA's requirements. One respondent argued that the power to designate a firm immediately "should only be exercised where the PRA considers that there is an imminent threat to its objectives that cannot be otherwise prevented". The Government believes that the process set out in the Order is clear, and does not require further elaboration in the instrument. Further detail is set out in the draft policy statement which is currently being consulted on by the Bank and FSA. Beyond that, the PRA is under a duty to have regard to the principle of proportionality in the exercise of its general functions, which applies to its approach to designation of firms under section 22A.

8.3 Lloyd's of London noted that the Order does not make secondary market activity a PRA-regulated activity, and expressed concern that this would have the unintended effect that Lloyd's would no longer have permission to carry on the secondary market activity. The Government can confirm that Lloyd's will continue to have permission to carry on that activity by virtue of an Order to be made under section 119 of the Act (transitional provisions). Provided Lloyd's carries on one PRA-regulated activity, it will be prudentially supervised by the PRA in respect of all its regulated activities. The FCA will be responsible for conduct of business supervision of the secondary market activity. It is therefore unnecessary to refer specifically to secondary market activity in the Section 22A Order.

9. Guidance

9.1 Further guidance on how the new regulators will interpret the order will be made available by the PRA and FCA.

10. Impact

10.1 The order, 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.