EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES (MISCELLANEOUS) (AMENDMENT) (EU EXIT) (NO. 2) REGULATIONS 2019

2019 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by Her Majesty's Treasury and is laid before Parliament by Command of Her Majesty.

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

2. Purpose of the instrument

2.1 This instrument is being made in order ensure a coherent and functioning financial services regulatory regime once the United Kingdom (UK) leaves the European Union (EU). It makes amendments to a number of financial services EU exit statutory instruments and to an EU delegated regulation, correcting errors identified in legislation after it was made, making amendments to ensure consistency between EU exit instruments and introducing a transitional provision. These amendments will ensure that these instruments operate effectively after the UK leaves the EU.

Explanations - What did any relevant EU or UK law do before exit day, how is it being changed, and what will it do now?

Amendments to the EU exit instruments establishing Temporary Permissions Regimes and Contractual Run-off Regimes for EEA firms

2.2 The EU's single market in financial services enables a financial services firm authorised in one EEA Member State to carry on business in any other EEA Member State. This arrangement is known as passporting. After exit, the UK will fall outside the EU's single market and EEA firms will no longer be able to operate in the UK via a passport. EEA firms wishing to continue carrying on business in the UK will need to apply for UK authorisation.

2.3 An important element of the Government's EU exit preparations for financial services is the Temporary Permissions Regime (TPR), which will allow EEA firms currently passporting into the UK to continue carrying on business here after exit day while they go through the process to become fully UK authorised. The TPR will help to provide continuity for the UK customers of these EEA firms and minimise disruption at the point of exit. The TPR was introduced by the EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018 (S.I. 2018/1149).

2.4 However, there will also be EEA firms with existing business in the UK that do not enter the TPR. There may also be firms that enter it, but do not subsequently receive authorisation from the UK regulators to undertake new business. For these firms, the Government introduced a 'run-off' mechanism via the Financial Services Contracts (Transitional and Saving Provision) (EU Exit) Regulations 2019 (S.I. 2019/405). Run-off is a process for the firm's existing business to be concluded, or 'run-off', in an orderly way. Firms in run-off are not permitted to write new business in the UK.

The run-off mechanism is designed to avoid disruption and uncertainty for the UK customers of these firms.

2.5 Part 2 of this SI supplements the existing provisions for the run-off mechanism by introducing an obligation on EEA firms which have no presence in the UK and enter the unsupervised run-off regime (part of the run-off mechanism, known as the 'Contractual Run-Off' regime). Because these firms will have no presence in the UK, they will continue to be subject to regulation in their home EEA state and will be exempt from UK regulation. The new obligation will require these firms to inform their UK customers of their status as an 'exempt firm' and to inform their UK customers of any changes to consumer protection arrangements, for example if the firm's home state consumer protection legislation changes. These amendments are designed to increase awareness for customers of firms that enter the regime.

2.6 Part 2 of this SI also amends the provisions for the run-off mechanism to correct a drafting error relating to EEA fund managers. Previously, the drafting implied that EEA fund managers were in scope of the run-off mechanism – this amendment corrects that to make clear that they are not in scope. EEA fund managers that wish to continue to manage UK authorised funds will need continued permission to carry on full business activities in the UK, as UK authorised funds are authorised to carry out new as well as existing business. As such, EEA fund managers can only continue managing a UK authorised fund after exit if they establish a presence in the UK by incorporation (setting up a UK company).

Amendments to the EU exit instruments establishing a Temporary Permissions Regime and Contractual Run-off Regime for EEA Payments Services and E-Money firms

2.7 The Government established a separate temporary permissions regime and run-off mechanism for EEA payment services and e-money firms, which are authorised under the EU's Payment Services Directive and Electronic Money Directive. This allows EEA payment services and e-money firms, which currently carry on business in the UK via a passport, to continue with their UK business for a temporary period after exit while they go through the process of becoming UK authorised.

2.8 Part 3 of this SI introduces an obligation on those institutions which enter the contractual run-off mechanism to inform their UK customers of the their "exempt" status, and any changes in consumer protection. This is similar to the obligation outlined in paragraph 2.5 above. It achieves this via amendments to the Electronic Money, Payment Services and Payment Systems (Amendment and Transitional Provisions) (EU Exit) Regulations 2018 (S.I. 2018/1201), as amended by the Financial Services Contracts (Transitional and Saving Provision) (EU Exit) Regulations 2019 (S.I. 2019/405).

2.9 Part 3 of this SI also inserts a further cancelation criterion to the temporary permissions regime, which mirrors an existing cancellation criterion in the Payment Services Regulations 2017 (S.I. 2017/752). Currently, EEA payments firms must have professional indemnity insurance or a comparable guarantee to provide account information services. An example of an account information service might be providing users with an electronic "dashboard" where they can view information from various payment accounts in a single place, such as through a mobile phone app. Under the provisions as drafted, the FCA would have an implicit power to cancel the temporary deemed authorisation or registration of an EEA payments firm or account

information service provider whilst in the temporary permissions regime, if the firm did not have insurance cover. This amendment makes that FCA power explicit in the circumstances outlined here.

Amendments to the Financial Conglomerates Regulations

2.10 The government has given the UK financial regulators the task of phasing in regulatory changes that will apply to financial services firms as a result of EU exit legislation, where that will be needed to mitigate disruption for financial services firms. Parliament approved this approach through Part 7 of the Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019 (S.I. 2019/632), which delegated a Temporary Transitional Power to the Bank of England, PRA and FCA.

2.11 In line with this approach, Part 4 of this SI amends the Financial Conglomerates and Other Financial Groups (Amendment etc.) (EU Exit) Regulations 2019 (S.I. 2019/264) to introduce a transitional provision enabling UK regulators (the PRA and the FCA) to delay, for up to two years, new supervision requirements that will apply to EEA financial conglomerates in the UK after exit. Currently EU rules, as implemented in UK law, specify that there is only one EEA coordinating supervisor for a financial conglomerate with business in the EEA. Once the UK is outside the EU's joint supervisory framework, there will need to be a UK coordinating supervisor for any EEA conglomerate with business in the UK. This could impose an additional layer of supervision for some conglomerates.

2.12 Because the UK implementation of EU Financial Conglomerates legislation places specific supervision obligations on UK regulators, it is necessary to temporarily amend these regulator obligations (for two years only, in line with the duration of the Temporary Transitional Power) so that the PRA and FCA are able to phase in new requirements for EEA conglomerates. The scope of the Temporary Transitional Power does not permit the regulators to vary their own obligations in legislation.

Amendments to the EU exit instrument on Long Term Investment Funds and the EU Delegated Regulation on Liquidity Coverage for banks and investment firms

2.13 In the Long-term Investment Funds (Amendment) (EU Exit) Regulations 2019 (S.I. 2019/336), a drafting error meant that references in the EU Regulation to European Long-term Investment Funds were not fully replaced with the term that will be used for UK only funds. In order to ensure that the scope of UK recognition for these funds is clear, this instrument ensures that all references to European funds are corrected as intended.

The Capital Requirements EU exit SI (The Capital Requirements (Amendment) (EU Exit) Regulations 2018 (S.I. 2018/1401)) should have included a provision to delete paragraph 2 of Article 29 in the Commission Delegated Regulation on Liquidity Coverage ((EU) 2015/61 of 10 October 2014). The paragraph relates to a discretion for national regulators to vary the liquidity coverage standard applied within groups under certain conditions. The Capital Requirements EU Exit SI removed this discretion from the Capital Requirements Regulation ((EU) No 575/2013) as this discretion will not be used in the UK. The deletion of paragraph 2, Article 29, is therefore in line with the deficiency fixes for liquidity coverage that Parliament has already approved.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 This instrument was proposed for sifting on 27 February 2019. The Commons sifting committee (the European Statutory Instruments Committee (ESIC)) disagreed with the government and recommended that this statutory instrument should be laid before, and approved by a resolution of, each House of Parliament before it is made (i.e. follow the affirmative procedure).

3.2 The ESIC stated that the amendments made by this instrument are potentially significant and they considered it would usually be appropriate to use the affirmative procedure when amending EU exit instruments which were themselves originally subject to the affirmative procedure.

3.3 The Lords sifting committee (the Secondary Legislation Scrutiny Committee (SLSC)) did not recommend this instrument be upgraded.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.4 The territorial application of this instrument includes Scotland and Northern Ireland.

3.5 The powers under which this instrument is made cover the entire United Kingdom (see section 2(2) of Schedule 2 to the European Communities Act 1972, and section 8(1) of, and paragraph 21 of Schedule 7 to the European Union (Withdrawal) Act 2018) and the territorial application of this instrument is not limited by either act or by the instrument.

4. Extent and Territorial Application.

4.1 The territorial extent of this instrument is to the whole United Kingdom.

4.2 The territorial application of this instrument is to the whole United Kingdom.

5. European Convention on Human Rights

5.1 The Economic Secretary to the Treasury (John Glen MP) has made the following statement regarding Human Rights:

"In my view the provisions of the Financial Services (Miscellaneous) (Amendment) (EU Exit) (No. 2) Regulations 2019 are compatible with the Convention rights."

6. Legislative Context

6.1 This instrument amends several pieces of secondary legislation, including the implementation of a transitional provision, and amends retained EU law to address deficiencies from the withdrawal of the UK from the EU.

6.2 The instrument amends the EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018, the Electronic Money, Payment Services and Payment Systems (Amendment and Transitional Provisions) (EU Exit) Regulations 2018, the Financial Conglomerates and Other Financial Groups (Amendment etc.) (EU Exit) Regulations 2019, and the Long-term Investment Funds (Amendment) (EU Exit) Regulations 2019.

6.3 The instrument additionally amends Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European

Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions.

7. Policy background

What is being done and why?

7.1 The UK and EU negotiating teams have agreed the terms of an implementation period that will start on exit day and last until 31 December 2020. Should a deal be approved, the implementation period will provide time to introduce the new arrangements that will underpin the UK-EU future relationship, and provide valuable certainty for businesses and individuals. During an implementation period, common rules will continue to apply. The UK would continue to implement new EU law that comes into effect and the UK would continue to be treated as part of the EU's single market in financial services. This would mean that access to each other's markets will continue on current terms and businesses, including financial services firms, will be able to trade on the same terms as now until 31 December 2020. UK firms would need to comply with any new EU legislation that becomes applicable during the implementation period.

7.2 The government is seeking a deep and special future partnership with the EU, which should be greater in scope and ambition than any such agreement before and encompass financial services. Given the highly regulated nature of financial services, the volume of trade between UK and EU markets, and a shared desire to manage financial stability risks, the UK proposes a new economic and regulatory arrangement that will preserve mutually beneficial cross-border business models and economic integration for the benefit of businesses and consumers. Decisions on market access would be autonomous in our proposed model, but would be underpinned by stable institutional processes in a bilateral agreement and continued close regulatory and supervisory cooperation.

7.3 While the UK and EU negotiating teams have agreed a deal and an implementation period, the government must continue to plan for all eventualities, including a 'no deal' scenario. HM Treasury intends to use powers in the European Union (Withdrawal) Act 2018 (EUWA) to ensure that the UK continues to have a functioning financial services regulatory regime in all scenarios.

7.4 The EUWA repeals the European Communities Act 1972 and converts into UK domestic law the existing body of directly applicable EU law (including EU Regulations). It also preserves UK laws relating to EU membership – e.g. legislation implementing EU Directives. This body of law is referred to as "retained EU law". The EUWA also gives ministers a power to prevent, remedy or mitigate any failure of EU law to operate effectively, or any other deficiency in retained EU law, through SIs. These contingency preparations for financial services legislation are sometimes referred to as 'onshoring'. These SIs are not intended to make policy changes, other than to reflect the UK's new position outside the EU, and to smooth the transition to this situation. The scope of the power is drafted to reflect this purpose and is subject to further restrictions, such as the inability to use the power to impose or increase taxation, or establish a public authority. The power is also time-limited and falls away two years after exit day.

7.5 Wherever practicable, the proposed approach is that the same laws and rules that are currently in place in the UK would continue to apply at the point of exit, providing

continuity and certainty as we leave the EU. However, if the UK does not enter an implementation period, some changes would be required to reflect the UK's new position outside the EU. HM Treasury has laid a package of EU Exit statutory instruments, making these changes. The majority of these instruments have now been made, and would come into force on exit day, if the UK did not enter an implementation period.

7.6 If the UK were to leave the EU without a deal, the UK would be outside the EU's framework for financial services. The UK's position in relation to the EU would be determined by the default Member State and EU rules that apply to third countries at the relevant time. The European Commission has confirmed that this would be the case.

7.7 In light of this, the approach in this scenario cannot and does not rely on any new, specific arrangements being in place between the UK and the EU. As a general principle, the UK would also need to default to treating EU Member States largely as it does other third countries, although there are cases where a different approach would be needed including to provide for a smooth transition to the new circumstances.

7.8 HM Treasury published a document on 27 June 2018, which sets out in more detail HM Treasury's approach to financial services legislation under the European Union (Withdrawal) Act. (https://www.gov.uk/government/publications/financial-services-legislation-under-the-eu-withdrawal-act).

7.9 This instrument is part of a wider package of statutory instruments being laid by HM Treasury from July 2018 onwards in order to ensure the UK continues to have a functioning financial regulatory framework after the UK leaves the EU.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument is being made using the power in section 8 of the European Union (Withdrawal) Act 2018 in order to address failures of retained EU law to operate effectively or other deficiencies arising from the withdrawal of the United Kingdom from the European Union.

9. Consolidation

9.1 There are currently no plans to consolidate the relevant legislation.

10. Consultation outcome

10.1 HM Treasury has not undertaken a consultation on the instrument. The financial services EU exit instruments that are amended under this instrument have been published and laid in draft beginning in July 2018. This instrument only makes minor amendments, to ensure a coherent and consistent regulatory regime on exit.

11. Guidance

11.1 No further guidance is being published alongside this instrument

12. Impact

12.1 There is no, or no significant, impact on business, charities or voluntary bodies.

12.2 The impact on the public sector is that some of the instruments being amended impact on the UK financial services regulators (the Bank of England/Prudential Regulation Authority and the Financial Conduct Authority and the Payment Systems Regulator). Impact assessments for the individual instruments being amended by this instrument have been published on legislation.gov.uk, apart from those that have been deemed to be de minimis.

12.3 An Impact Assessment has not been prepared for this instrument because in line with Better Regulation guidance, HM Treasury considers that the net impact on businesses will be less than £5 million a year. Due to this limited impact, a de minimis impact assessment has been carried out.

13. Regulating small business

13.1 The legislation applies to small businesses. However it does not introduce new regulatory requirements for small businesses, but merely ensures a consistent and coherent regulatory regime.

14. Monitoring & review

14.1 As this instrument is made under the EU (Withdrawal) Act 2018, no review clause is required.

15. Contact

15.1 Rachel Mumford at HM Treasury Telephone: 020 7270 5636 or email: Rachel.Mumford@hmtreasury.gov.uk can be contacted with any queries regarding the instrument.

15.2 Katie Fisher, Deputy Director for Financial Services EU Exit Domestic Preparation at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.

15.3 John Glen MP, Economic Secretary to the Treasury can confirm that this Explanatory Memorandum meets the required standard.

Annex

Statements under the European Union (Withdrawal) Act 2018

Part 1

Table of Statements under the 2018 Act

This table sets out the statements that may be required under the 2018 Act.

Statement	Where the requirement sits	To whom it applies	What it requires
Sifting	Paragraphs 3(3), 3(7) and 17(3) and 17(7) of Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) to make a Negative SI	Explain why the instrument should be subject to the negative procedure and, if applicable, why they disagree with the recommendation(s) of the SLSC/Sifting Committees
Appropriate-ness	Sub-paragraph (2) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2	A statement that the SI does no more than is appropriate.
Good Reasons	Sub-paragraph (3) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2	Explain the good reasons for making the instrument and that what is being done is a reasonable course of action.
Equalities	Sub-paragraphs (4) and (5) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2	Explain what, if any, amendment, repeals or revocations are being made to the Equalities Acts 2006 and 2010 and legislation made under them. State that the Minister has had due regard to the need to eliminate discrimination and other conduct prohibited under the Equality Act 2010.
Explanations	Sub-paragraph (6) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2 In addition to the statutory obligation the Government has made a political commitment to include these statements alongside all EUWA SIs	Explain the instrument, identify the relevant law before exit day, explain the instrument's effect on retained EU law and give information about the purpose of the instrument, e.g., whether minor or technical changes only are intended to the EU retained law.
Criminal offences	Sub-paragraphs (3) and (7) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9, and	Set out the 'good reasons' for creating a criminal offence, and the penalty attached.

		23(1) or jointly exercising powers in Schedule 2 to create a criminal offence	
Sub-delegation	Paragraph 30, Schedule 7	Ministers of the Crown exercising sections 10(1), 12 and part 1 of Schedule 4 to create a legislative power exercisable not by a Minister of the Crown or a Devolved Authority by Statutory Instrument.	State why it is appropriate to create such a sub-delegated power.
Urgency	Paragraph 34, Schedule 7	Ministers of the Crown using the urgent procedure in paragraphs 4 or 14, Schedule 7.	Statement of the reasons for the Minister's opinion that the SI is urgent.
Explanations where amending regulations under 2(2) ECA 1972	Paragraph 13, Schedule 8	Anybody making an SI after exit day under powers outside the European Union (Withdrawal) Act 2018 which modifies subordinate legislation made under s. 2(2) ECA	Statement explaining the good reasons for modifying the instrument made under s. 2(2) ECA, identifying the relevant law before exit day, and explaining the instrument's effect on retained EU law.
Scrutiny statement where amending regulations under 2(2) ECA 1972	Paragraph 16, Schedule 8	Anybody making an SI after exit day under powers outside the European Union (Withdrawal) Act 2018 which modifies subordinate legislation made under s. 2(2) ECA	Statement setting out: a) the steps which the relevant authority has taken to make the instrument published in accordance with paragraph 16(2), Schedule 8 available to each House of Parliament, b) containing information about the relevant authority's response to— (i) any recommendations made by a committee of either House of Parliament about the published instrument, and (ii) any other representations made to the relevant authority about the published instrument, and, c) containing any other information that the relevant authority considers appropriate in relation to the scrutiny of the instrument or instrument which is to be laid.

Part 2

Statements required when using enabling powers under the European Union (Withdrawal) 2018 Act

1. Appropriateness statement

1.1 The Economic Secretary to the Treasury, John Glen MP, has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

"In my view the Financial Services (Miscellaneous) (Amendment) (EU Exit) (No. 2) Regulations 2019 does no more than is appropriate".

1.2 This is the case because: it follows the approach taken in previous instruments to fix deficiencies that arise as a result of the UK leaving the EU. This instrument makes amendments and corrections to ensure that UK financial markets continue to operate in a fair, stable and transparent manner post EU withdrawal. Additionally, this instrument makes the appropriate amendments to EU legislation that will become redundant once the UK is no longer a member of the EU.

2. Good reasons

2.1 The Economic Secretary to the Treasury, John Glen MP, has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

"In my view there are good reasons for the provisions in this instrument, and I have concluded they are a reasonable course of action".

2.2 These are: the approach taken with this instrument is consistent with the approach previously taken in earlier instruments, and maintains the intended effect of those instruments. The corrections made to the instruments are necessary to ensure that legislation operates effectively once the UK leaves the EU, and the amendments go no further than what is required for this purpose.

3. Equalities

3.1 The Economic Secretary to the Treasury, John Glen MP has made the following statement(s):

"The instrument does not amend, repeal or revoke a provision or provisions in the Equality Act 2006 or the Equality Act 2010 or subordinate legislation made under those Acts.

3.2 The Economic Secretary to the Treasury, John Glen MP has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

"In relation to the instrument, I, John Glen MP, Economic Secretary to the Treasury, have had due regard to the need to eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Equality Act 2010."

4. Explanations

4.1 The explanations statement has been made in section 2 of the main body of this explanatory memorandum.