EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2000 (PRUDENTIAL REGULATION OF FCA INVESTMENT FIRMS) (DEFINITIONS FOR THE PURPOSES OF PART 9C) REGULATIONS 2021

2021 No. 1046

1. Introduction

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

2. Purpose of the instrument

2.1 This instrument is being made to provide further detail to two definitions in Part 9C Financial Services and Markets Act 2000 (FSMA). In particular, this instrument sets out the detailed scope of the definitions of 'parent undertaking' and 'group'. By providing the scope of these definitions, this instrument will support the effective management of the risks faced by UK investment firm groups regulated by the Financial Conduct Authority (FCA). In turn, this will help the operation of an effective and proportionate Investment Firm Prudential Regime (IFPR), as introduced by the Financial Services Act 2021 (FS Act).

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

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 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

6. Legislative Context

6.1 The FS Act introduced, in Part 9C FSMA, a new regime for the prudential regulation of UK investment firms by the FCA (i.e. the IFPR). Most of the firms that will be subject to the new regime are currently regulated by the Prudential Regulation Authority (PRA) through the capital requirements regulation. The new regime provides regulation which is tailored to investment firms and the risks that they face. From the date when the IFPR applies, it will also apply to UK investment firms that are not currently subject to the Capital Requirements Regulation (CRR). It is anticipated that the FCA's new regulatory regime will come into force on 1 January 2022.

6.2 The purpose of prudential regulation is to ensure that financial firms control risks and hold suitable levels of capital corresponding to those risks. The IFPR provides a

framework for the prudential regulation of the applicable firms and their holding companies in a more proportionate manner compared to their current regulation by the PRA under the CRR.

6.3 Part 9C also gives the FCA powers to make rules in relation to parent undertakings of FCA-regulated firms (whether the parent is itself authorised or not). These powers provide that the FCA may make rules to be satisfied on an individual basis for a single entity or in relation to the consolidated position of the group of firms under the parent.

6.4 In order to set a framework within which the FCA should exercise these powers, which for the first time include powers in relation to groups and parent undertakings, section 143B(2) FSMA, in Part 9C, provides that the Treasury may further define "parent undertaking" and "group".

7. Policy background

What is being done and why?

7.1 The IFPR is a prudential regime tailored to non-systemic UK investment firms. These firms are not considered systemically important to the UK's financial system and will be regulated by the FCA. Systemically important investment firms in the UK will continue to be regulated by the Prudential Regulation Authority in accordance with the CRR and CRR rules.

7.2 The definitions in Part 9C FSMA use the current FSMA definitions of 'group' and 'parent undertaking'. As a result of powers in the FS Act, HM Treasury has the power to make changes to these definitions that relate to prudential consolidation.

7.3 Prudential consolidation helps manage the risks that consolidation groups – or investment firm groups in the case of the IFPR – are exposed to by dint of their group membership. This risk could occur where a group contains firms that are not themselves subject to regulatory oversight, but where the financial situation and activities of such unregulated firms could impact the situation and activities of regulated firms from within the same group.

7.4 HM Treasury wants to more closely align the definitions in Part 9C FSMA with the approach taken in the CRR. Therefore, this instrument amends the scope of the two IFPR prudential consolidation definitions to reflect the scope of the relationships currently covered under Article 18 CRR. This instrument does not make [material] policy changes. Instead, it seeks consistency for industry and the FCA when it comes to the scope of prudential consolidation definitions, and by correcting the scope of these definitions it provides an effective and proportionate prudential regime.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

9. Consolidation

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

10. Consultation outcome

10.1 HM Treasury ran a public consultation on the implementation of certain aspects of the IFPR (and Basel 3) in Q1 2021. HM Treasury did not receive any responses directly relevant to this SI.

10.2 The FCA also published a consultation in Q4 2020 on the IFPR rules, which did not receive any materially consequential responses from industry.

10.3 HM Treasury has discussed this instrument with the Financial Conduct Authority to inform the development of this instrument.

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 There is no, or no significant, impact on the public sector.

12.3 A full Impact Assessment has not been prepared for this instrument because the impact is small (the cost to businesses is < £5m per year). A de minimis Impact Assessment has been prepared, which shows that by maintaining the legal status quo the effect of this instrument will have a minimal (familiarisation) impact.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses, if they fall within the scope of the IFPR.

14. Monitoring & review

14.1 The instrument does not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015, the Economics Secretary to the Treasury (John Glen MP) has made the following statement:

"It is not proportionate to include a review clause in this instrument because the impact of these further definitions within FSMA on businesses in scope, and the impact of the amendments, are very low."

15. Contact

15.1 Jos Kelly at Her Majesty's Treasury, Jos.Kelly@hmtreasury.gov.uk, can be contacted with any queries regarding the instrument.

15.2 Fayyaz Muneer, Deputy Director for Green and Prudential at Her Majesty's Treasury, can confirm that this Explanatory Memorandum meets the required standard.

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