

Explanatory note: Draft directions under Part 7 of the Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019 (Transitional Powers of the Financial Regulators)

Introduction

The Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019 (FSMA Regulations 2019) have been laid and debated in Parliament. This legislation, if made, would give us (and the Bank of England and the Prudential Regulation Authority) the power to temporarily waive or modify obligations on UK-supervised persons where those obligations have changed under section 8 of the EU (Withdrawal) Act 2018 because of the UK's withdrawal from the EU (the Brexit onshored legislation). This power would only be used if the UK leaves the EU without an implementation period. The directions have been prepared on the assumption that the EU exit statutory instruments referred to in them will be in force by exit day.

Statutory context

Part 7 of the FSMA Regulations 2019 sets out our powers to make temporary transitional directions. Where we are making a transitional direction, regulation 203 in Part 7 (Notification and publication of transitional directions) requires us to prepare and publish alongside publication of the direction(s) the following material:

- (i) an explanation of the purpose of the direction,
- (ii) such guidance in connection with the direction as the regulator considers appropriate, and
- (iii) a statement to the effect that the regulator is satisfied that giving the transitional direction(s) would not adversely affect the advancement of its key objectives viewed collectively.

This explanatory note and the draft directions set out this material.

Purpose of the directions

The purpose of these draft directions is to give effect to our use of the temporary transitional power should the UK leave the EU with no implementation period. This gives affected persons time to implement changes arising from the Brexit onshoring legislation.

Our approach to using the power

On 1 February 2019, we published a statement¹ outlining our intention to use this power broadly, with targeted exceptions. This general 'standstill' means that, for most requirements, firms and other regulated persons will not need to comply with changes to their regulatory obligations resulting from Brexit onshored legislation from exit day. Instead, they will generally be able to continue to comply with the requirements as they had effect before exit day for a limited time (until 30 June 2020). However, in the areas where we will not use the power, we expect firms and other regulated persons to undertake reasonable steps to comply with the changes by exit day.

¹ <https://www.fca.org.uk/news/statements/brexit-what-we-expect-firms-now>

To identify exceptions to our use of the power, we used the following criteria:

- (i) where a failure to meet the onshored requirements would adversely affect the advancement of our key objectives, viewed collectively,
- (ii) where we have material supervisory concern about delay in firms' compliance, and
- (iii) where compliance with pre-exit requirements is impossible or impracticable.

As set out in our February statement, the Treasury has already introduced transitional regimes to address some of the most significant changes to regulatory obligations. We have also included transitional provisions in the rules we consulted on and have published as near final. Where there are existing transitional regimes we have not used the power, as we do not expect disruption to firms to arise.

We are also not proposing to use this power in relation to changes to the regulatory perimeter, including in relation to financial promotions. The legislative amendments made by the Treasury in these areas include transitional provisions. We are conscious that changes to the perimeter can have far-reaching consequences, including for our powers and the application of our rules. If firms are concerned about specific changes to the perimeter which may cause disruption, we are willing to consider whether further directions are required.

Some of the changes to Brexit onshored legislation result in a reduction in territorial scope for the relevant requirements from the EU to the UK. This means that where UK firms must currently comply with certain requirements across the EU (including the UK), after exit firms will be required to comply with those requirements only in the UK. Where this is the case, firms will or should be complying with the post-exit regime already, and we are not proposing to use the power on the basis that we do not expect disruption to arise.

As noted in our February 2019 statement, for some provisions the effect of the power may interact with proposed powers² for the Treasury to make equivalence decisions. In line with the Bank of England (Bank) and the Prudential Regulation Authority (PRA), our draft directions apply the temporary transitional power only in respect of two areas where this is the case (concerning capital requirements and credit ratings respectively). For all other areas, we will not at this time use the power, which would achieve the same outcome as the Treasury making an equivalence decision, for the duration of the transitional relief. We will keep this approach under review, noting that the Treasury may decide to make an equivalence decision in these areas. Therefore, we may need to revise the draft directions closer to exit day. Directions made under the temporary transitional power would automatically cease to apply in relation to any areas where the Treasury subsequently makes an equivalence decision that would have a similar effect as the power.

Guidance about the directions

We have made two directions: the FCA Transitional Direction (with two annexes) and the FCA Prudential Transitional Direction (with an annex). Should the UK leave the EU without an implementation period, the directions will take effect from exit day until midnight on 30 June 2020. After 30 June 2020, all onshored changes will apply without modification. Both directions include guidance to help firms understand the temporary transitional power.

FCA Transitional Direction

This direction applies a general 'standstill' and covers mainly conduct requirements. It builds in optionality. This means that firms - including temporary permission (TP) firms³ – and other

² http://www.legislation.gov.uk/ukdsi/2019/9780111178607/pdfs/ukdsi_9780111178607_en.pdf

³ This term includes supervised run-off firms under Part 6 of the EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018.

regulated persons will not breach a requirement if they continue to comply with the obligation as they did before exit day, but it is also open to them to comply with the post-exit obligation. In relation to TP firms, the TP substituted compliance direction allows for substituted compliance with European Economic Area (EEA) Home State rules in certain areas, in a similar way to our approach to the application of rules to TP firms.

The 'standstill' direction only applies to the areas specified in the Annexes to the direction. Annex A applies the standstill direction across regulatory requirements that arise from changes in secondary legislation made by the Treasury and the FCA's instruments amending binding technical standards. Annex B to the direction sets out the application of the standstill direction to our Handbook. The annexes include guidance on the obligations which will change and the effect of the standstill direction where it applies.

This direction also sets out areas where the standstill direction will not apply. This includes perimeter-related changes and where the onshored changes reduce the geographic scope of application after exit. Our analysis has shown that many of the amendments do not give rise to changes for firms, particularly given the existing transitional provisions. It has therefore not been necessary to apply the standstill in many cases.

The TP substituted compliance direction applies where the temporary permission legislation⁴ leads to changed obligations for TP firms. Specific exclusions to the TP substituted compliance direction are set out in Part 5 of the transitional direction, together with guidance. The TP substituted compliance direction is not limited to those matters set out in the Annexes A and B. Part 5 also sets out directions allowing for substituted compliance for specified incoming firms in relation to the onshored Distance Marketing Regulations.⁵ Finally, Part 5 contains directions enabling certain credit institutions within the Treasury's financial services contracts regime⁶ to provide limited payment services.

FCA Prudential Transitional Direction

This direction covers onshored prudential requirements (such as capital requirements and bank recovery and resolution) that we share with the Bank and the PRA. It does not allow optionality, making it mandatory for firms to continue to comply with the effect of pre-exit requirements. This is in line with the Bank's and the PRA's approach.

Set of directions

Together, the FCA Transitional Direction and the FCA Prudential Transitional Direction are a set of directions for the purposes of regulation 200(7) of the FSMA Regulations 2019.

Effect of the set of directions

We are satisfied that the set of directions will prevent or mitigate disruption that could reasonably be expected to arise for firms and other regulated persons, viewed collectively, from compliance with the unmodified obligations viewed collectively, for the period in relation to which the set of directions is to have effect.

Effect on advancement of our key objectives

⁴ Regulations 8(3), 11(3), 28(3) and 34(3) of the EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018.

⁵ The Financial Services (Distance Marketing) Regulations 2004, S.I. 2004/2095 (as amended).

⁶ Certain credit institutions within Parts 6 and Part 7 of the EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018.

We are satisfied that the set of directions does not adversely affect the advancement of our key objectives (consumer protection, integrity and competition) viewed collectively. More specifically, given the significant volume of the onshoring changes to which firms and consumers would need to adjust to in a short timeframe, using the temporary transitional power allows for an orderly transition. This limits disruption. However, in circumstances where we consider there is a risk to our key objectives, we have created exceptions to our use of the temporary transitional power.

Consultation with other regulators and the Treasury on use of the temporary transitional power

We are obliged to consult the Treasury on a draft of the proposed direction. The Bank, the PRA and the FCA are also subject to an obligation to consult each other on the use of the temporary transitional power.

The set of directions published today has benefited from close coordination and consultation with the Treasury, the Bank and the PRA. Following the end of our consultation on proposed changes to the regulatory framework, we exchanged with the Bank and the PRA the responses to our respective industry engagement on the power, and our proposed approach. We also exchanged with the Bank and the PRA our respective draft directions in relation to the implementation of the power. These were shared with the Treasury.

In advance of publishing our final set of directions, we will provide copies to the Treasury, the Bank and the PRA.

Next steps

We will publish the final set of directions ahead of exit day. Firms and other regulated persons should read the draft directions and guidance. We do not expect to make further changes to these directions in the areas where we expect firms to take steps to comply by exit day, or to the duration of the transitional relief. However, we invite firms to engage with us on the impact of our use of the temporary transitional power and to make us aware of any specific changes that they believe are not fully accounted for, or where the draft directions could provide further clarity.