

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

September 2019

Introduction

The Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019 (FSMA Regulations 2019) 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 will only be used if the UK leaves the EU without an implementation period.

We have previously published directions under the Temporary Transitional Power. Below, we highlight the changes made since March 2019.

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 (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 directions set out this material.

Purpose of the directions

The purpose of these 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 31 December 2020). However, in the areas where we are not using the

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

power, we expect firms and other regulated persons to undertake reasonable steps to comply with the changes by exit day.

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.

The Treasury has already introduced transitional arrangements to address some of the most significant changes to regulatory obligations. Where there are existing transitional arrangements we have not generally used the power, as we do not expect disruption to firms to arise.

We are also not generally using 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.

Some of the changes to Brexit onshored legislation mean a reduction in the geographical scope of obligations. For example, various UK obligations will no longer apply to activities carried on from an establishment in the EEA. Where this is the case, firms will or should be complying with their post-exit obligations already and, therefore, should not need time to adapt to the changes.

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 directions apply the 'standstill' in the following areas of overlap:

- (i) Capital calculations for EEA exposures; and
- (ii) Use of credit ratings issued by EU entities for regulatory purposes.

For all other areas, we are not at this stage using the power in a way that achieves the same outcome as the Treasury making an equivalence decision. We will keep this approach under review. Directions made under the temporary transitional power will automatically cease to apply in relation to any areas where the Treasury subsequently makes an equivalence decision that has the same effect as the power.

Changes to our directions since publication on 29 March 2019

The main changes that we have made to the directions since publishing them on 29 March 2019 are:

- (i) We have extended the proposed duration of the directions issued under the temporary transitional power from 30 June 2020 to 31 December 2020.³
- (ii) The directions have been updated to reflect prudential instruments that have been made since 29 March. We are continuing with our previous approach of applying the pre-exit regime (with the exceptions as set out before), and have updated the prudential direction and annexes to take into account new HMT legislation, and FCA exit instruments, since 29 March 2019.

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

³ As noted in our update published on our website on 25 July 2019: <https://www.fca.org.uk/publications/policy-statements/ps19-5-brexite-policy-statement>.

- (iii) The new main FCA transitional directions revoke the directions set out in paragraphs 5.15 to 5.19 of that direction published in March. These were directions in relation to payment services provided by EEA credit institutions in the financial services contracts regime. There is now no need for these directions because of the amendments made in Part 3 of the Financial Services (Electronic Money, Payment Services and Miscellaneous Amendments (EU Exit) Regulations 2019 (S.I. 2019/1212).
- (iv) We have applied the standstill direction to the changes made by the Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019 to paragraphs 2 and 3 of the Schedule to the Financial Services and Markets Act 2000 (Exemption) Order 2001, meaning that EEA Central Banks and the ECB may continue to rely upon their status as exempt persons for the duration of the transitional relief.

Guidance about the directions

We have made two directions: the main FCA transitional directions (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 31 December 2020. At this stage, after 31 December 2020, all onshored changes will apply without modification. Both directions include guidance to help firms understand the effect of our directions.

Main FCA transitional directions

These directions contain a standstill direction that covers mainly conduct requirements. The standstill direction builds in optionality. This means that firms - including temporary permission (TP) firms⁴ - and other 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 in 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.

These directions also set 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 where we have 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 legislation⁵ leads to changed obligations⁶ 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

⁴ This term includes supervised run-off firms under Part 6 of the EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018.

⁵ Regulations 8(3), 11(3), 28(3) and 34(3) of the EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018.

⁶ Obligations which are reserved before exit day to firm's home state under a relevant directive.

substituted compliance direction is not limited to those matters set out in 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.⁷

FCA prudential transitional direction

This direction covers onshored prudential requirements (such as capital requirements and recovery and resolution requirements) 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 main FCA transitional directions 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

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 directions. 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. We also exchanged with the Bank and the PRA our respective draft directions in relation to the implementation of the power.

Next steps

We do not expect to make further changes to these directions. 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.

We have prepared these directions on the basis that the following statutory instruments (SIs) will be made before exit day – if the SIs are not made, or there is a delay in making them, changes may be required to our directions:

⁷ The Financial Services (Distance Marketing) Regulations 2004, S.I. 2004/2095 (as amended).

- The Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment etc., and Transitional Provision) (EU Exit) (No.2) Regulations 2019; and
- The Financial Services (Miscellaneous) (Amendment) (EU Exit) (No.3) Regulations 2019.