



Financial Services (Implementation of Legislation) Bill [HL] **HL Bill 143 of 2017–19**

Summary

The Financial Services (Implementation of Legislation) Bill [HL] is a government bill, which had its first reading in the House of Lords on 22 November 2018 and is due its second reading on 4 December 2018. The bill would provide a delegated power to enable the Treasury to make corresponding or similar provision to specified pieces of EU financial services legislation in the event that the UK leaves the European Union without a deal.

The financial services industry is of particular importance to the UK economy, contributing 6.5 percent of its total economic output. Currently, most financial services regulation is made at EU level and is either directly applicable or transposed into domestic law by secondary legislation.

In preparation for leaving the EU, the European Union (Withdrawal) Act 2018 (EUWA) incorporates all EU law on the day of exit into UK law to provide continuity and so that existing regulation continues to have effect after Brexit. If the UK ratifies the withdrawal agreement, it will enter an implementation period until December 2020, during which EU law will continue to apply. During this period the UK will continue to implement financial services regulation through secondary legislation. However, if the UK leaves the EU with no deal, there will be no mechanism through which financial services regulation can be updated without the need for primary legislation.

There are several pieces of in-flight EU financial services legislation, which have either been adopted by the EU but will not be implemented by the time the UK leaves, or that are currently under negotiation and may be adopted shortly after. The bill proposes to give the Treasury the power to make provision for these specified items in UK law, subject to any adjustments appropriate to make them suitable for a UK context. The power is subject to the same restrictions on scope as the correcting power in the EUWA and may only be used up to two years after exit day. The bill proposes that statutory instruments made in accordance with the power be subject to the affirmative resolution procedure, which requires a vote in both Houses. The Treasury will be required to produce annual reports on the use of the power.

The House of Lords Delegated Powers and Regulatory Reform Committee is due to publish its opinion on the bill before committee stage in the House of Lords.

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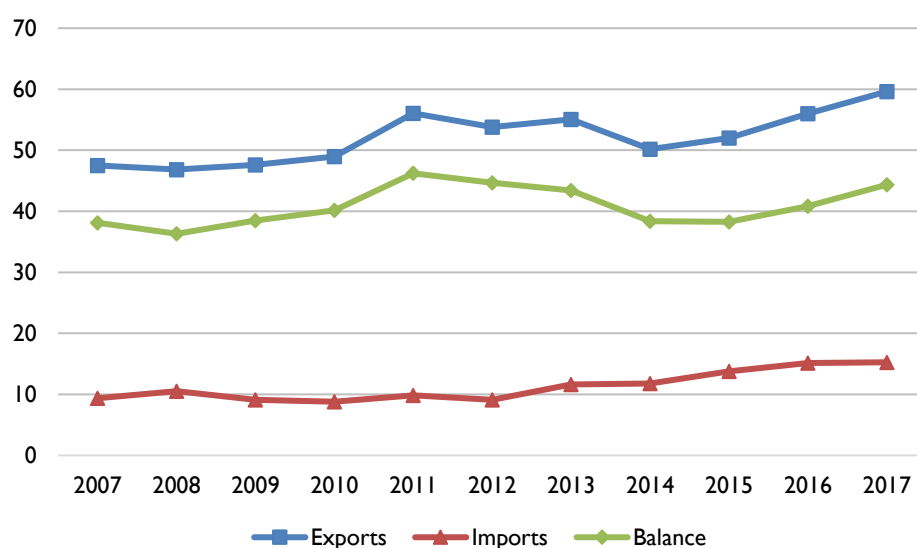
I. Background

I.1 Financial Services in the UK

Financial services are an important feature of the UK economy. According to the Institute for Fiscal Studies “[f]inancial services are unusually important [...] even relative to other developed economies. UK financial services trade is twice the EU average and three times the OECD average”.¹ In 2017, the financial services sector contributed 6.5 percent of the UK’s total economic output,² and HMRC received £28.5 billion in tax receipts from the banking sector.³

The UK has consistently run a significant trade surplus in financial services, as demonstrated in Figure 1. In 2017 the balance of trade was £44 billion.⁴

Figure 1: UK Trade in Financial Services 2007–2018 in £ Billions



(Source: Office for National Statistics, [The Pink Book: 2018](#), 31 July 2018)

The UK’s current financial services regulatory system can be described as multi-level,⁵ with many decisions being made at EU level:

The majority of the UK’s financial services legislation currently derives from EU law. Financial services is a highly regulated sector, and the EU

¹ Carl Emmerson, Paul Johnson and Ian Mitchell, [The EU Single Market: The Value of Membership Versus Access to the UK](#), Institute for Fiscal Studies, August 2016, p 16.

² House of Commons Library, [Financial Services: Contribution to the UK Economy](#), 25 April 2018, p 5.

³ HM Revenue and Customs, [Pay-As-You-Earn and Corporate Tax Receipts from the Banking Sector](#), 13 September 2018, p 7.

⁴ Office for National Statistics, [The Pink Book: 2018](#), 31 July 2018.

⁵ See: House of Lords European Union Committee, [Brexit: The Future of Financial Regulation and Supervision](#), 27 January 2018, HL Paper 66 of session 2017–19, p 9.

internal market for financial services is highly integrated, underpinned by common rules and standards, and extensive supervisory cooperation between regulatory authorities at an EU and member state level.⁶

Whilst the UK remains a member of the EU, it is bound by EU regulations which are directly applicable in UK law.⁷ It is also obliged to translate EU financial services directives into UK law, which is usually done through secondary legislation, under section 2(2) of the European Communities Act 1972.⁸

The UK's membership of the EU and the single market means that firms, financial market infrastructures and funds based in the UK and authorised by UK regulators can operate freely in other member states and members of the European Economic Area. This is known as passporting.⁹

The ability to provide services to the EU is particularly important for UK-based central counterparty clearing houses (CCPs): entities that place themselves between the original counterparties to a financial transaction, effectively guaranteeing that if one party fails to complete the transaction, the CCP will step in.¹⁰ The UK is currently a major centre for Euro-dominated derivatives clearing and so such arrangements are also important for EU member states.¹¹

1.2 Financial Services and Brexit

In preparation for the UK leaving the EU, the European Union (Withdrawal) Act 2018 (EUWA) repeals the European Communities Act 1972, removing the effect of EU law in UK law on exit day. The act will also convert all EU law as it stands on the day of exit into UK law, which will become known as retained EU law.¹² This means that the financial regulations that apply to the UK as a member of the EU will continue to apply in the UK after Brexit until amended or disapplied by the UK Parliament. The act also creates powers for ministers to correct retained EU law so that it is functional in UK statute.

⁶ HM Treasury, [HM Treasury's Approach to Financial Services Legislation Under the European Union \(Withdrawal\) Act](#), 27 June 2018, p 1.

⁷ House of Lords European Union Committee, [Brexit: The Future of Financial Regulation and Supervision](#), 27 January 2018, HL Paper 66 of session 2017–19, p 9.

⁸ [Explanatory Notes](#), p 3.

⁹ HM Treasury, [Banking, Insurance and Other Financial Services If There's No Brexit Deal](#), 23 August 2018.

¹⁰ Amandepp Rehlon and Dan Nixon, '[Central Counterparties: What Are They, Why Do They Matter and How Does the Bank Supervise Them?](#)', *Bank of England Quarterly Bulletin*, 2013 Q2, p 148.

¹¹ House of Lords European Union Committee, [Brexit: The Future of Financial Regulation and Supervision](#), 27 January 2018, HL Paper 66 of session 2017–19, p 22.

¹² House of Commons Library, [The Status of "Retained EU Law"](#), 30 July 2018.

The arrangements in place for UK financial services after exit day will depend on whether the UK ratifies the withdrawal agreement, or whether the UK has left the EU without a deal.

Proposals Under the Government's Deal

The draft withdrawal agreement contains provision for an implementation period, during which time EU law would continue to apply.¹³ Legislation that will give the agreement domestic effect, the European Union (Withdrawal Agreement) Bill, will amend the EUWA to continue to apply the European Communities Act 1972 until 2020.¹⁴ A Treasury document outlined the implications for the financial sector:

During the implementation period, common rules will continue to apply. The UK will continue to implement new EU law that comes into effect and the UK will continue to be treated as part of the EU's single market in financial services. This will 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 will need to comply with any new EU legislation that becomes applicable during the implementation period.

During this period, EU financial services firms operating in the UK, and UK financial services firms operating in the EU, will be able to continue to undertake regulated activities, either by means of passporting rights or under other relevant EU frameworks. Similarly, UK financial market infrastructures that are authorised under the existing EU framework, such as central counterparties [CCPs], will continue to be able to provide services to the EU. EU and third country (non-EU) financial market infrastructures that have existing authorisation or recognition under EU legislation will continue to be able to provide services to the UK, enabling access to financial market infrastructures without disruption.¹⁵

According to the draft political declaration of the future relationship between the EU and the UK, by the end of the transition period the UK and the EU hope to have arrangements in place which would enable “close and structured cooperation on regulatory and supervisory matters” related to financial services. However, the UK would no longer be subject to EU rules

¹³ HM Government, [Explainer for the Agreement on the Withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union](#), 14 November 2018.

¹⁴ Department for Exiting the European Union, [Legislating for the Withdrawal Agreement between the United Kingdom and the European Union](#), July 2018, Cm 9674, pp 18–20.

¹⁵ HM Treasury, [HM Treasury's Approach to Financial Services Legislation Under the European Union \(Withdrawal\) Act](#), 27 June 2018, p 1.

and both parties would have regulatory autonomy.¹⁶

As the regulatory frameworks of the EU and UK may diverge, passporting would no longer be possible. However, the declaration states the intention that UK and EU organisations would still be able to access each other's markets through equivalence decisions, in which each party recognises the other's regulations is compliant with, and equivalent to, its own.¹⁷

No Deal Preparations

If the UK has not ratified the withdrawal agreement by 29 March 2019 the UK would leave the EU without a deal.¹⁸ In this circumstance, EU legislation would cease to apply to the UK on 30 March 2019. The EUWA would ensure that any EU legislation in force before this date is preserved in UK law, however, concerns have been raised about in-flight EU legislation.

In its report, *Brexit: The Future of Financial Regulation and Supervision*, the House of Lords European Union Financial Affairs Sub-Committee noted:

A key concern is what is often called “in-flight” legislation, which is legislation that has been agreed but that has not fully entered into force before the point at which the UK leaves the EU.¹⁹

The committee cited evidence from Professor Eilís Ferran, Professor of Company and Securities Law at the University of Cambridge, which said:

We are going to convert EU law that is in force and applicable as at [the date of withdrawal]. Satisfying the law ‘in force and applicable’ requirement is potentially problematic if we have staggered starts to EU regulation, and we have not already completed the process of writing all the technical rules. That will give rise to legal uncertainty.²⁰

In a committee stage debate on the European Union (Withdrawal) Bill, chair of the Sub-Committee, Baroness Falkner of Margravine, also raised this issue, highlighting that “much of EU financial services regulation takes four or five years to come into effect”.²¹

¹⁶ HM Government, [Draft Political Declaration Setting out the Framework for the Future Relationship between the European Union and the United Kingdom](#), 22 November 2018, pp 8–9.

¹⁷ House of Commons Library, [Brexit and Financial Services](#), 23 August 2018, pp 12–13.

¹⁸ Unless an extension to the article 50 period is granted.

¹⁹ House of Lords European Union Committee, [Brexit: The Future of Financial Regulation and Supervision](#), 27 January 2018, HL Paper 66 of session 2017–19, p 28.

²⁰ *ibid.*

²¹ [HL Hansard, 12 March 2018, col 1486.](#)

The Financial Services (Implementation of Legislation) Bill aims to provide a mechanism through which retained EU legislation can be updated by statutory instrument in the event of a ‘no deal’ scenario. The bill’s explanatory notes outline why the Government thinks this is necessary:

This law is complex and highly detailed, with much introduced in the period since the financial crisis. Being unable to update this body of law (such as to respond to market developments or to international regulatory developments) except through primary legislation represents a risk to the reputation, global competitiveness and efficiency of the UK’s financial markets.

In particular, a number of important pieces of EU legislation are currently making their way through the European legislative process. These cover a range of financial services policy areas, and in many cases the UK has played a leading role in shaping them for the benefit of the UK financial services industry.²²

The bill “provides for a delegated power to deal specifically with these expected changes to the body of financial services law that are currently in the EU pipeline”.²³ It applies to specified pieces of in-flight European Union financial services legislation that have been adopted but are not yet in force or are currently in negotiation.²⁴

In the event of no deal, the UK would remain outside of the EU’s regulatory framework and “UK firms’ position in relation to the EU would be determined by the relevant member state rules and any applicable EU rules that apply to third countries (countries outside of the EEA) at that time”.²⁵ As such, in addition to the Financial Services (Implementation of Legislation) Bill, the Government has announced a number of measures to minimise disruption in this scenario, including:²⁶

- a temporary permission regime “that will allow EEA firms currently passporting into the UK to continue operating in the UK for up to three years after exit, while they apply for full authorisation from UK regulators”;
- a temporary recognition regime for non-UK central counterparties clearing houses (CCPs) to allow them to continue providing clearing services for up to three years;

²² [Explanatory Notes](#), p 2.

²³ *ibid.*

²⁴ *ibid.*

²⁵ HM Treasury, [Banking, Insurance and Other Financial Services If There’s No Brexit Deal](#), 23 August 2018.

²⁶ *ibid.*

- legislation “to ensure that contractual obligations (such as under insurance contracts) between EEA firms and UK-based customers that are not covered by the temporary permissions regime can continue to be met; and
- providing UK financial services regulators with a “general transitional tool that will allow them to phase in post-exit regulatory requirements for firms where these are related to the UK leaving the EU” to give firms time to adjust.

Whilst the EU has not committed to reciprocal measures in many of these areas, it has said that it will “adopt temporary and conditional equivalence decisions” for UK central counterparties clearing houses (CCPs). It states that “[t]hese decisions will be complemented by recognition of UK-based infrastructures, which are therefore encouraged to pre-apply to the European Securities and Markets Authority (ESMA) for recognition”.²⁷

2. Bill Provisions

Powers in the Bill

Clause 1 would enable the Treasury to “make provision corresponding or similar to specified EU financial services legislation” in UK law by statutory instrument.²⁸ It will also enable ministers to “make any adjustments the Treasury consider appropriate, including (in particular) adjustments in connection with the withdrawal of the United Kingdom from the EU”.²⁹ This would allow the Government to:

- choose to implement only those EU files,³⁰ or parts of those files, which it deems beneficial for the United Kingdom; and
- adjust the legislation as it is brought into domestic law to fix any deficiencies and to ensure that it works best in a UK context.³¹

The stated purpose of this power is to allow the Government to “implement legislation which reflects the interests of the UK market and its participants”.³²

²⁷ European Commission, [Preparing for the withdrawal of the United Kingdom from the European Union on 30 March 2019: a Contingency Action Plan](#), 13 November 2018, p 8.

²⁸ [Explanatory Notes](#), p 4.

²⁹ *ibid.*

³⁰ EU legislative proposals that are not yet UK law.

³¹ [Explanatory Notes](#), p 4.

³² *ibid.*

EU Regulations and Directives to Which the Power Applies

The bill names the specific pieces of in-flight legislation that ministers may make provision for. There are two categories of legislation:

- “those that have been adopted, but do not yet apply so are not captured by the EUWA or regulations made under it”;³³ these are specified in sub-sections 2(a) to 2(f) of the bill.
- “those that are proposed while the United Kingdom is a member of the EU but which will be finalised in the two years subsequent to EU exit.”;³⁴ these are listed in schedule 1 of the bill.

A summary of the aims of the in-flight files listed on the face of the bill is available on pages 2 to 4 of the [memorandum from the HM Treasury to the Delegated Powers and Regulatory Reform Committee](#) (22 November 2018). More detailed information on each of the pieces of legislation is also available in pages 5 to 12 of the [Financial Services \(Implementation of Legislation\) Bill: Policy Note](#) (28 November 2018).

Limitations of the Power

As well as being limited to certain specified pieces of EU legislation, the power is subject to the same limitations as the correcting power in the EUWA. Regulations may make any provision that could be made by an Act of Parliament but may not:

- impose or increase taxation or fees,
- make retrospective provision,
- create a relevant criminal offence,
- establish a public authority,
- be made to implement the withdrawal agreement,
- amend, repeal or revoke the Human Rights Act 1998 or any subordinate legislation made under it, or
- amend or repeal the Scotland Act 1998, the Government of Wales Act 2006 or the Northern Ireland Act 1998.³⁵

The bill contains a sunset clause so that the power could only be used for up to two years after exit day.

The use of the power would be subject to the affirmative resolution procedure; this means that a draft statutory instrument must be laid and

³³ [Explanatory Notes](#), p 2.

³⁴ *ibid.*

³⁵ European Union (Withdrawal) Act 2018, section 8(5) and 8(7).

approved by both Houses before a regulation may be made.

The bill would also require the Treasury to produce annual reports on the use of the power.

3. Use of Delegated Legislation Powers

The bill contains similar delegated legislation powers to the EUWA, which when introduced drew criticism from the House of Lords Delegated Powers and Regulatory Reform Committee for giving “excessively wide law-making powers to ministers”.³⁶

In some sense the scope of the power in the Financial Services (Implementation of Legislation) Bill is narrower than the EUWA, as it would only apply to specified pieces of EU legislation. However, in other ways it is broader: it allows the Government to make provision to implement EU legislation that will become law after the UK ceases to be a member of the EU; and permits ministers to make “any adjustments the Treasury consider appropriate” as opposed to just those considered appropriate to correct deficiencies in retained law, as with the EUWA.

The Government justified the scope of the power in its memorandum to the Delegated Powers and Regulatory Reform Committee:

Given the number of files in question, and the potential requirement to implement them to respond to market developments, maintain competitiveness and to meet 5 international obligations, it will not be feasible to rely on primary legislation in each and every instance.

Since these files are, in many cases, still under negotiation, it is critical that the UK has the power to implement only those files, or parts of those files, which are necessary and beneficial for the UK. There will also clearly be uncertainty as to how the negotiations around each “in-flight” file listed in the schedule will conclude once the UK has exited the EU, and it is possible that the legislation might not accommodate for the specificities or interests of the UK market. A power is therefore needed to make adjustments to the legislation to fix any deficiencies and to ensure that it applies appropriately to UK markets.³⁷

The memorandum also said that “[t]he Government acknowledges that this proposal is a broad power, and recognises that it must be temporary and

³⁶ House of Lords Delegated Powers and Regulatory Reform Committee, [European Union \(Withdrawal\) Bill](#), 28 September 2017, HL Paper 22 of session 2017–19, p 2.

³⁷ HM Treasury, [Financial Services \(Implementation of Legislation\) Bill: Memorandum from HM Treasury to the Delegated Powers and Regulatory Reform Committee](#), 22 November 2018, p 5.

limited” and highlighted the safeguards the bill proposed be placed on the use of the power.³⁸ In addition to this, the Government also made the following non-legislative assurances:

- Committing to only use the powers where there was no alternative means, short of new primary legislation, of implementing the EU file (or part of it).
- Committing to adopting a consistent approach to the distribution of roles and responsibilities between Government and the regulators to that established for financial services under the European Union (Withdrawal) Act 2018.
- Committing to undertake extensive engagement and cooperation with key stakeholders throughout the process.³⁹

The Delegated Powers and Regulatory Reform Committee will consider the Financial Services (Implementation of Legislation) Bill on 12 December 2018 and is expected to report before committee stage in the House of Lords begins.

³⁸ HM Treasury, [Financial Services \(Implementation of Legislation\) Bill: Memorandum from HM Treasury to the Delegated Powers and Regulatory Reform Committee](#), 22 November 2018, p 5.

³⁹ HM Treasury, [Financial Services \(Implementation of Legislation\) Bill, Policy Note](#), 28 November 2018.