PIMFA
Building Personal Financial Futures

HOUSE OF LORDS CONSTITUTION COMMITTEE INQUIRY

EUROPEAN UNION (WITHDRAWAL) BILL

CALL FOR EVIDENCE

About PIMFA

The Personal Investment Management & Financial Advice Association ("PIMFA") was created on 1 June 2017 by the merger between the Wealth Management Association ("WMA") and the Association of Personal Financial Advisers ("APFA"). PIMFA's members (numbering over 2,200 firms) cover a broad spectrum of business offering wealth management, investment and personal financial advice, and execution services, and PIMFA is the main UK organisation representing this sector. While mostly focussed on clientele in the United Kingdom, a number of our members also have businesses in the European Union or provide cross-border services into the European Union, and are therefore directly impacted by Brexit.

Introduction

1. We welcome the opportunity to submit evidence to the House of Lords EU (Withdrawal) Bill inquiry. We acknowledge the challenges the Bill presents and we would like to address the theme of the rule of law and legal certainty with regards to the financial services industry.

2. In particular, our response focuses on financial services legislation and analyses the question of 'The legal and practical challenges of producing a copy of retained EU law post-exit'. In this response, we would like to draw the attention of the Constitution Committee to the following issues:

1. The way in which the EU Bill will be influenced by the outcome of the EU-UK Brexit negotiations;
2. The difference between technical and substantial changes to the Bill when converting EU retained law into domestic law;
3. The role of EU law for UK-EU relations after Brexit and how to handle future divergence which may occur between UK, EU and the rest of the world;
4. The need for transparency and consultation with the financial services industry in drafting the Bill; and
5. The need to advocate for a one-step Brexit process that creates minimal disruption to industry and firms.

The UK model for financial services

3. Financial services legislation tends to be technical in character with a mix of primary and secondary law, and principles and rules made by the regulators, such as FCA and PRA. FSMA gives the FCA general rule making powers in section 155 FSMA: "(1)If the Authority proposes to make any rules, it must publish a draft of the proposed rules

in the way appearing to it to be best calculated to bring them to the attention of the public". These rules are reflected in the FCA Handbook which presents the legal instruments and their changes in a single view.

4. This model allows financial services law to be flexible in the areas that require modification on an ongoing basis. One of the key challenges for our sector will therefore be the process of transferring and keeping the EU *acquis* while allowing for both the UK method of making rules and their role in the UK legal framework.

Flexibility on the approach to rules

5. The main priority with regards to the Brexit negotiations and more specifically with regards to the implementation of the EU Bill is to avoid inconsistencies and to make sure that laws can be functional from exit day. In order to ensure that this can happen after Brexit, the Government is expected to be using the powers contained in clause 7 of the EU Bill to correct 'deficiencies'.

6. This clause refers to 'dealing with deficiencies arising from withdrawal' and gives the Government the power to make secondary legislation to modify deficiencies from EU retained law that would arise on exit day. Clause 7(2) then explains the sorts of deficiencies this power may include, such as those provisions on reciprocal arrangements or rights between the UK and other EU member states that are no longer in place or are no longer appropriate. This list is not exhaustive and the wording of the clause is not clearly defined. Consequently it could be difficult to determine what Ministers may consider as a deficiency in retained EU law. Given the wide scope of the instruments in retained EU law that will need to be considered under the EU Bill, we have some concerns with regards to the application of these powers in our sector – it will be relevant to assess how the potential to create secondary legislation as awarded by these powers may affect the flexibility needed for financial services rule-making and application.

7. Converting EU law cannot be to the detriment of the flexibility that the UK model allows in financial services legislation. The explanatory notes to the EU Bill refer to the powers to correct deficiencies given by the EU Bill as analysed below, saying: "*there will also be cases where retained EU law will cease to operate as intended or will be redundant once the UK leaves the EU. For this reason, the Bill includes a power to enable ministers to correct problems arising from withdrawal by way of making regulations by statutory instruments*".

8. Secondary law needs to be preserved through the EU Bill to avoid gaps in the future, however the EU Bill refers specifically to statutory instruments – which cannot be modified. We would not want to find a situation where a statutory instrument has been agreed and provides no flexibility as needed in the financial services sector.

9. Some of the EU derived laws may only need some technical changes to be fully implemented as UK law – for example, references to EU members or EU institutions. However there could be some areas where the Government may need to discuss policy considerations and where changes would be considered as substantial – for example new powers to UK authorities. Because Clause 7 does not specify what '*powers to make necessary changes to EU law'* may mean, there is uncertainty as to the extent of the changes the Government can or cannot undertake in relation to EU retained law.

Policy changes

10. Following recent publications by Parliament, it has become clear that a distinction needs to be drawn between the technical changes in domesticating EU Law and the discretion to implement new policies, especially those related to competences previously held by EU institutions.

11. Primary legislation could use a copy-out approach while transposing secondary legislation (more technical) could be a matter for the regulator – for PIMFA this means the FCA. As referred to above, the FCA could then publish consultation papers on topics with a higher risk for deficiencies and where a policy decision needs to be taken (and under their rule making powers).

12. The model used for the EU Bill needs to be flexible in order to allow future changes. This means that implementation for financial services law should not be hard-coded and should seek flexibility in order to be able to adapt to the dynamic nature of business.

13. Below we present two examples of inconsistencies that may arise in our industry: in respect of the Prospectus Regulation and of UCITS.

The Prospectus Regulation: Developing a reasonably sized and liquid UK retail bond market has been a major issue in recent years. The recent agreement on Level 1 of the new Prospectus Regulation (known as PD4) may have helped this cause by allowing bonds to be issued in any denomination free of expensive retail market requirements provided they can be bought only by Qualified Investors (QIs). These include firms managing retail portfolios so small-denomination bonds issued under wholesale arrangements can enter the retail market only via their good auspices, thus adding to investor protection while opening retail possibilities. Further work on this topic in light of Brexit is needed, as regulators and practitioners will need to think about how to make this market operate if the EU Bill brings some inconsistencies to light – for example, which body would need to be in charge of approving prospectuses from other countries, and could bonds issued by companies in (other) EU member states still be available to QIs in the UK after Brexit as the new PD4 allows while we remain an EU member state? It will clearly be necessary to analyse the policy choices overall in order to avoid unwanted constraints in the UK retail bond market once the UK is out of the EU.

UCITS: As regards UCITS, such funds domiciled in the UK will not be deemed to be UCITS funds after Brexit; to continue as such they will need to be re-domiciled to another member state. Without doing so they would be exposed to a paraphernalia of restrictions regarding marketing in other EU member states. In the UK they might become unavailable to retail investors by virtue of no longer being UCITS. Moreover, there is a question mark over whether the delegation back principle, whereby a fund manager in one EU member state can manage funds domiciled in another, could continue to apply to the UK as a third country after Brexit. If not, and if UK-domiciled UCITS disappear, there will be extra costs and potentially more limited choices for UK retail investors wising to invest in funds. This will mean that policy choices will have to be made about how private investors and the firms working for them can in the future access funds no longer available under current EU rules and which in some cases may most easily be made available in the future by not applying those rules in the UK.

Outcome of negotiations: maintaining the value of private investment

14. Thus the outcome of the Brexit negotiations is likely to influence the way in which the EU Bill may have practical effect. This will influence access to markets and funds on a commercial plane, as well as conditioning politically sensitive areas such as the role of the CJEU.

15. For this reason we recommend a one-step Brexit implementation process. Minimal disruption for businesses is needed. For this the UK and EU27 should continue to have access to one another's markets on current terms for a minimum of 2 years' transition following the end of the Article 50 notification period, as we argued in our response to the recent House of Lords Inquiry into Financial Regulation and Supervision following Brexit. This PIMFA view was supported by the Prime Minister's Florence speech on 22 September, which described proposals for a smooth and orderly Brexit based on the concept of a phased departure process. This will benefit all key parties by eliminating shocks and ensuring that business will only have to make one change, not two, in order to adjust to new market and regulatory circumstances. The transition period should include the maintenance of open access to the widest possible pool of skilled labour to meet a key industry concern, and the Prime Minister's reassurance on this was welcome.

16. The avoidance of a cliff-edge scenario for the financial services sector is essential to avoid both endangering the value of the hard-earned savings and investment of private investors and their families, and creating chaos for the industry by sudden changes to regulation and the range of choices of investment vehicles.

17. In a future post-Brexit world there may be an opportunity for UK domestic regulation to target more accurately the structures and business approaches specific to the UK's financial services industry. We believe however that this must be aligned with the UK continuing to maintain both the highest regulatory standards and its role as a leading exporter of high quality regulation both regionally and internationally. In this context, when discussing 'equivalence' and its implications for UK-based businesses accessing the EU market, it should be recalled that the concept works both ways and there may sometimes be requirements for others to seek equivalence to UK standards, rather than vice versa.

The role of global standards after Brexit

18. UK courts and regulators may want to consider the effects of decisions coming from the EU after Brexit, especially if the UK maintains some level of access to EU markets and services.

19. There have been different suggestions in this area. For example, as regards the handling of potential divergence in regulatory approaches and any adverse impact this may have on market access, the International Regulatory Strategy Group (IRSG) has proposed a Forum for Regulatory Alignment that could assess potential material divergences and recommend action.

20. Once the UK leaves the EU, we would expect there to be regular roundtables and summits to be held between relevant European Institutions, notably the European Commission, and UK Authorities, to discuss financial services issues such as market access or the enforceability of law in cross-border retail contracts. The Forum for Regulatory Alignment could be a useful component in this post-Brexit UK/EU relationship management system.

21. Global standards and the work of global standards setters, such as IOSCO or the FSB, will also be important in this set of arrangements. The UK is a participant in these fora and as indicated above is a known exporter of regulatory concepts, which have a material impact on global standard creation. As a ‘third country’ to the EU following Brexit, the UK may benefit from emphasising the degree to which adherence to global standards could have a part to play in intermediating between the UK and EU.

22. This could be particularly important in helping to manage regulatory divergence and alleviate both it and its consequences. In turn there could be benefits for the assessment and maintenance of equivalence, especially by refocusing attention on equivalence in regulatory and related outcomes, rather than in detailed rule inputs.

23. This will likely be important for substantial segments of the financial services industry, and will help to maintain market access and regulatory certainty for business. It will also help business for private investors and to maintain the value of their private investments and savings.

Other practical challenges arising from withdrawal

24. **ESAs:** The transposition of EU law into UK law will encounter a particular issue in the financial services sector because of the role and position of the European Supervisory Authorities, or ESAs. There is no equivalent in the UK, especially as regards their functions in the development and implementation of financial service regulation and in overseeing the activities of the National Competent Authorities, or NCAs. The ESAs have a specific legal requirement to ensure that the NCAs’ work is adequately undertaken and consistent. They have powers to compel change of regulatory approach by an NCA if it is not. Once we are out of the EU this challenge will no longer be available. It means that the UK NCA – the FCA – will have nothing between the consultation process marking the manner in which it creates rules, and a judicial review of its decisions, to challenge whether it is regulating and supervising in the best and most appropriate manner. In particular, there is no mechanism to tell the Regulator it has made a mistake and should change course. An unaccountable public authority with this amount of power and freedom may not be desirable, and in our view a new UK method of replacing the challenge and indeed control over regulatory excess or error offered by the ESAs should be developed. The work on the Withdrawal Bill should include an evaluation of how this might best be done and relevant clauses should be inserted.

25. **Directive and Regulation:** A second issue specific to the financial services sector is the use of Regulation as opposed to Directive to create EU law, which is then nationally implemented by the member states. Directives are implemented through national Parliaments and in this way turned into national law. In the UK this is put into practical effect in the usual way by regulation and rule-making by the NCAs. The language and method of creating rules from EU law are thus familiar to the local market and its participants.

26. But Regulations, which were new in the EU following the financial crisis of 2007-9, do not go down this route. They are created by the same process as Directives in the tripartite work undertaken by the European Commission, the European Parliament, and the European Council, but they are implemented by the ESAs directly. So a Regulation does not go through any national Parliamentary process in any member state but remains at the European level. It is instead put into effect by the relevant ESA (in the capital markets area this is mostly the European Securities and Markets Authority, or ESMA) receiving from the European Commission the final version of the rules (following a lengthy consultation process) giving effect to the EU law. The ESA then forwards this to all NCAs with the instruction to implement nationally un-amended.

27. The effect is that two types of EU law exist in the financial services sector, one that has gone through national implementation and one that has been imposed directly from above. This leads to differences in the way the rules are written and on the Regulation side a more alien approach to rule-making and language use in national markets. In repatriating EU law to the UK attention should be paid to this difference and allowance made for the requirement to expose Regulations to the same consultation and other scrutiny processes for rule-making that UK financial services law normally requires.

Directives, Regulations and the private investor

28. In the retail financial services sector PIMFA has promoted the use of Directives rather than Regulations because the interposition of national Parliaments and rule-making allows some domestic interpretation and aligns the law and rules more closely to local practice. This is more important in the retail than the wholesale sector because it is far less internationalised. It is a more effective method for consumer protection purposes and helps mitigate any obvious infelicities where EU law does not quite match the way things are done locally. The one-size-fits-all tendency inherent in the Regulation process can often be inappropriate where local markets vary considerably. In the Directive process retail consumers feel less remote from the rules and institutions which are designed to help them because in the end the implementation is done locally and EU law becomes nationalised. All the more reason to ensure in the Withdrawal Bill that account is taken of the need to refit Regulations in particular to the UK circumstance.

PIMFA
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