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FINANCIAL SERVICES BILL REVIEW

SPEED READ:

- The Financial Services Bill aims to enhance the UK's prudential standards and promote financial stability, promote openness between the UK and international markets and improve the effectiveness of the UK regulatory framework.
- The Financial Services Bill introduces a tailored Investment Firms Prudential Regime (IFPR) to enable a more balanced approach of regulation and reporting towards investment firms.
- The legislation actively encourages financial institutions to move away from the LIBOR benchmark as quickly as possible. The Bill grants the FCA new and enhanced powers to deal with tough legacy contracts however fails to provide much clarity around the synthetic LIBOR rate, at this stage.
- The Bill enables the implementation of the outstanding Basel III and 3.1 standards which will improve the current UK prudential framework by enhancing liquidity standards and reporting obligations.
- Financial institutions should expect to see changes to prudential standards as well as enhancements to existing regulations alongside new rules in a post Brexit UK.
- Financial institutions should continue to allocate necessary resources and investment to regulatory evolution, their regulatory change programmes and prepare for a continued period of adjustment whilst the UK settles into a post Brexit era.

INTRODUCTION

On 21 October 2020, the Financial Services Bill was introduced to the House of Commons by the UK government. On December 3rd, the Bill passed the Committee stage of the House of Commons and is now due to have its report stage (however a date for this phase is yet to be determined). The report stage gives MPs an opportunity to debate the bill and propose amendments prior to the third reading, the final stage in the House of Commons before moving to the House of Lords.

The key objective of the Bill is to ensure that the UK financial services sector continues to be a core part of the global financial market post Brexit. The Bill contains a broad range of measures that will affect firms across the financial sector, as well as firms seeking to maintain access to the UK after the end of the Brexit transition period on 31 December 2020.

The Financial Services Bill touches on three key areas:

- The Bill will enhance the UK's prudential standards and promote financial stability by enabling the implementation of the full set of Basel III standards and a new prudential regime for investment firms, and will give the Financial Conduct Authority (FCA) the powers it requires to manage an orderly transition away from the LIBOR benchmark.
- The Bill will also promote openness between the UK and international markets.
- The Bill will introduce several measures to maintain the effectiveness of the financial services' regulatory framework and the sound operation of capital markets.

PRUDENTIAL STANDARDS AND PROMOTING FINANCIAL STABILITY

The current prudential regulation's objective is to ensure investment firms, credit institutions and other financial institutions have sufficient risk management processes and financial resources in place to carry on providing key services throughout economic and financial cycles.

The UK government's current position is that the existing framework falls short in adequately supporting investment firms in the UK in the following ways:

- The current requirements do not account for varying business models and size differences of investment firms;
- The current rules do not sufficiently evaluate the risks that investment firms are exposed and do not adequately account for the risks that these firms may inflict on the integrity of the UK financial system and consumers;
- UK investment firms may also be subjected to unnecessary administrative and compliance burdens as they are mandated to comply with a regime that is designed for credit institutions in mind rather than investment firms.

The Financial Services Bill introduces a tailored Investment Firms Prudential Regime (IFPR) to help remediate the issues noted above. The Bill will enable the implementation of a more balanced approach of regulation and reporting towards investment firms.

- **London Inter-Bank Offered Rate (LIBOR)**

  Financial institutions continue to be actively encouraged by the UK government to move away from LIBOR to an alternative benchmark by the end of 2021. The UK government has acknowledged the issues associated with certain legacy contracts. Despite the transition away from LIBOR rate, there is recognition that there will be a small number of challenging, multilateral legacy contracts that will remain an issue post go-live.

  The Bill gives the FCA enhanced powers to determine that a benchmark is unrepresentative or is at risk of becoming unrepresentative. This means that the FCA can designate a change to the methodology so that references in tough legacy contracts to the LIBOR rate will be treated as a reference to the new methodology, the synthetic LIBOR rate rather than a rate which no longer exists. Although the Financial Services Bill offers a solution to tough legacy contracts, it does not actually define what is a 'tough legacy contract' and how it would be used in practice.

  As the Bill stands, there are several points that still remain unclear at this late stage of the transition period – the Bill fails to provide full clarity around the synthetic LIBOR rate; specifically, what currencies and tenors will be included. The Bill also fails to outline what the practical implications of moving away from LIBOR will be between the UK and international counterparts. Financial institutions should continue to monitor the FCA for comment as it is highly likely that they will provide further clarity regarding interpretation of the Bill in the coming weeks.

- **Basel III**

  The Bill will enable the implementation of the outstanding Basel III and 3.1 standards. The new Basel standards will improve the current UK prudential framework by enhancing liquidity standards, and reporting obligations. The Financial Services Bill outlines an accountability framework to apply when the Prudential Regulation Authority (PRA) begins to implement the Basel standards. The Bill will afford rule-making responsibilities to the PRA, and this in turn will ensure that the UK's prudential regulation regime is more flexible in nature. This will ensure continuity and minimise any potential disruption to firms whilst they undergo a transition from the European Union Capital Requirement Regulation rules to UK-based PRA rules.

  Due to the COVID-19 pandemic, Basel III implementation efforts and preparations have been delayed until 2023; for its part, the UK regulator has taken steps to reduce capital and liquidity requirements on banks to support them in providing credit and liquidity to the economy. Looking forward, the Basel Committee will likely take time to assess the effectiveness of implementation efforts and may make amendments via legislative proposals that modify the crisis management framework. It is likely that the UK may diverge from the EU's approach, though at this stage it is uncertain how significant that divergence will be. However it should be noted that divergences and national discretion are inherent features of the Basel III framework. While any UK specific implementation requirements will not become clear until mid-2022, in the interim there is still wider preparation work that UK banks can undertake to maximise their readiness.

OVERSEAS MARKET OPENNESS

- **Gibraltar Authorisation Regime**

  The Financial Services Bill contains measures to ensure continued access between Gibraltar and mainland UK for financial services after the Brexit transition period.

- **Overseas Funds Regime**

  The Bill ensures that overseas investment funds have access to the UK markets by creating a regime that allows access to recognised collective investment schemes from approved overseas countries or territories. The Bill also outlines a regime for the admission of overseas money market funds to the UK.

- **Markets in Financial Instruments Regulation (MiFIR)**

  The Bill updates the UK onshore version of the Markets in Financial Instruments Regulation (UK MiFIR). It illustrates the changes to the UK's framework for cross-border access by overseas firms to the UK market, which will require the assessment of third country equivalence by UK Treasury. This will enable the FCA to have appropriate oversight on firms that could register under the new regime.

REGULATORY FRAMEWORK CHANGES

- **Market Abuse Regulation**

  The Bill will make amendments to the Market Abuse Regulation to bolster the effectiveness of the current regime while reducing several administrative requirements on issuers. Amendments to the regulation are focused on insider information, insider lists and transactions with senior managers. The Bill will also increase the maximum prison sentence for market abuse from seven to ten years in line with other sentences for financial crimes.

- **European Market Infrastructure Regulation (EMIR REFIT)**

  This measure will ensure that clearing members and clients that offer clearing services do so on a fair, reasonable, non-discriminatory, and transparent basis. The Financial Services Bill aims to improve trade repository data quality and make it easier for firms to move from one trade repository to another.

- **Banking Act in relation to the Financial Collateral Arrangement Regulations (FCARs)**

  This measure will safeguard the Financial Collateral Arrangement Regulations and promote certainty within the markets.

- **Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation**

  The Bill will aim to enhance the functioning of the on-shored PRIIPs Regulation by enabling the FCA to create clearer rules around the scope of the Regulation. It will also permit the UK Treasury to further extend the exemption currently in place for Undertakings for the Collective Investment in Transferable Securities (UCITS) funds.

MISCELLANEOUS

- **Cancellation of the authorisation of firms**

  This measure will enhance the FCA's process for removing a firm's authorisation by removing them from the public register. This will promote accuracy within the public register and reduce the risk of fraud.

- **Term of the FCA Chief Executive**

  The Bill legislates to make the appointment of the FCA CEO subject to a fixed, once renewable five-year term. This will bring the appointment in line with other posts of a similar nature, whose appointments are subject to statutory term limits.

- **Increasing beneficial ownership transparency for Trusts**

  The Bill aims to increase beneficial ownership transparency for Trusts. This in turn will clarify the Government's ability to enforce and make changes to extra-territorial trust registration powers.

- **Statutory Debt Repayment Plan (SDRP)**

  This measure aims to help the UK public to access professional debt advice and to help those in need reach sustainable debt solutions through the amendment of the Financial Guidance and Claims Act (FGCA). The FGCA made provisions to create a debt re-payment scheme in 2018 and it consisted of two parts: The Breathing Space and Statutory Debt Repayment Plan (SDRP).

  The Breathing Space scheme will offer those in need a sixty-day freeze period on enforcement action and fees whilst they engage with professional debt advice services. This will be introduced in May 2021. The Statutory Debt Repayment Plan will help revise agreements between debtor and creditors to make repayments more manageable for those in problem debt.

- **Help to Save Successor Accounts**

  The Help to Save scheme was set up in 2018 to help encourage savings among people in low income jobs. Help to Save bank accounts close after four years. The Bill ensures that when a Help to Save bank account matures and the bank account holder has not transferred it elsewhere, the balance can be transferred into a standard National Savings & Investments account automatically.

CONCLUSION

The Financial Services Bill is the first step towards the UK Government's twin objectives of maintaining its competitive position within the global financial services industry and capitalising on new opportunities following the close of the Brexit transition period.

Financial institutions are closely monitoring the Government, the regulators and other stakeholders such as the Bank of England in anticipation of an effective financial services regulatory regime for the UK in a post Brexit era. As the Bill makes its way through Parliament, the overarching message for financial institutions remains clear – financial institutions should expect to see changes to prudential standards as well as enhancements to existing regulations alongside new rules in a post Brexit UK.

Accordingly, financial institutions should continue to allocate necessary resources and investment to their regulatory change programmes and prepare for a continued period of adjustment whilst the UK settles into a post Brexit era.

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