PARLIAMENTARY DEBATES

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OFFICIAL REPORT

Eighth Delegated Legislation Committee

DRAFT FINANCIAL MARKETS AND INSOLVENCY (AMENDMENT AND TRANSITIONAL PROVISION) (EU EXIT) REGULATIONS 2019

Tuesday 5 February 2019

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not later than

Saturday 9 February 2019

The Committee consisted of the following Members:

Chair: Sir Christopher Chope

Abrahams, Debbie *(Oldham East and Saddleworth)* (Lab)
† Blackman, Bob *(Harrow East)* (Con)
† Blackman, Kirsty *(Aberdeen North)* (SNP)
† Glen, John *(Economic Secretary to the Treasury)*
† Hepburn, Mr Stephen *(Jarrow)* (Lab)
† Johnson, Gareth *(Dartford)* (Con)
† Knight, Julian *(Solihull)* (Con)
† Lopez, Julia *(Hornchurch and Upminster)* (Con)
† Mercer, Johnny *(Plymouth, Moor View)* (Con)
† Pearce, Teresa *(Erith and Thamesmead)* (Lab)
† Reynolds, Jonathan *(Stalybridge and Hyde)* (Lab/Co-op)
† Shuker, Mr Gavin *(Luton South)* (Lab/Co-op)
† Smith, Jeff *(Manchester, Withington)* (Lab)
† Walker, Thelma *(Colne Valley)* (Lab)
† Whittaker, Craig *(Lord Commissioner of Her Majesty's Treasury)*
† Whittingdale, Mr John *(Maldon)* (Con)
† Wragg, Mr William *(Hazel Grove)* (Con)

Peter Stam, *Committee Clerk*

† attended the Committee

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[Sir Christopher Chope *in the Chair*]

Draft Financial Markets and Insolvency (Amendment and Transitional Provision) (EU Exit) Regulations 2019

2.30 pm

The Economic Secretary to the Treasury (John Glen): I beg to move,

That the Committee has considered the draft Financial Markets and Insolvency (Amendment and Transitional Provision) (EU Exit) Regulations 2019.

It is a pleasure to serve under your chairmanship, Sir Christopher. As part of contingency preparations for a no-deal scenario, the Treasury has been undertaking a programme of legislation to ensure that if the UK leaves the EU without a deal or implementation period, there continues to be a functioning legislative and regulatory regime for financial services in the UK. The Treasury is laying statutory instruments before the House under the European Union (Withdrawal) Act 2018 to deliver that, and a number of debates on statutory instruments have already been undertaken in this place and in the House of Lords. The SI being debated today is part of that programme and was debated in the House of Lords yesterday.

The SI will fix deficiencies in UK law for financial markets and insolvency regulations to ensure that they continue to operate effectively post exit. The approach taken in this legislation aligns with that of other SIs being laid under the withdrawal Act—providing continuity by maintaining existing legislation at the point of exit, but amending where necessary to ensure that it works effectively in a no-deal context. The instrument being debated today concerns insolvency-related protections that are provided to systems and central banks under the EU settlement finality directive. "Systems" for these purposes are entities such as central counterparties, central securities depositories, and payment systems. These systems provide essential services and functions relied on by the financial services sector. For example, central counterparties stand between counterparties in financial contracts, becoming the buyer to every seller and the seller to every buyer. They guarantee the terms of a trade even if one party defaults on the agreement, reducing counterparty risk.

Under the SFD, a European economic area-based system can be designated by its member state's designating authority. Once a system is designated, funds or securities placed in that system by a system user cannot be clawed back in the event of the system user going into insolvency. This framework is intended to benefit both systems and their users. In particular, a system may provide services on more favourable terms to a user if it has SFD protections in place. In certain cases, membership of a system is contingent on those protections being provided, as that is an essential tool for the system to manage risks. Designation is therefore important, as it facilitates the smooth functioning of, and confidence in, financial markets.

The Bank of England and the Financial Conduct Authority are the designating authorities in the UK. When the Bank or FCA designates a system, it currently informs the European Securities and Markets Authority—ESMA—which places it on the EU register of designated systems. The SFD provides similar protections to central bank functions across the EEA. Collateral received by an EEA central bank in accordance with its functions, such as emergency lending, cannot be clawed back if the relevant counterparty to the central bank is subject to insolvency proceedings. The relevant EU laws—the SFD and the financial collateral arrangements directive—are implemented in the UK via the Financial Markets and Insolvency (Settlement Finality) Regulations 1999, the Companies Act 1989, the Financial Collateral Arrangements (No. 2) Regulations 2003 and the Banking Act 2009.

Should the UK leave the EU without a deal or implementation period, there will be no framework for the UK to recognise systems designated in EEA jurisdictions, which in turn may risk the continuity of services from those designated systems for UK firms. This SI introduces changes to mitigate risks to UK firms, to ensure that settlement finality protections continue to operate effectively following the UK's withdrawal. First, the SI introduces a UK framework for designating any non-UK system. To do that, the Bank of England's existing powers to designate and charge fees will be expanded to non-EEA systems, so that they can be designated under UK law. Moreover, the Bank of England will be able to grant protections to non-UK central banks, including EEA central banks, that already receive protections under the SFD. That will help to maintain the effect of the current framework, providing continuity to UK firms accessing systems and central banks, while assisting UK firms in accessing the global market. In making those changes, the SI also maintains existing designations for UK systems that were made by the Bank of England before exit day.

Secondly, the SI establishes a temporary designation regime. That provides temporary designation for a period of three years to existing designated EEA systems that intend to be designated under the new UK framework. The purpose of temporary designation is to allow time for designation applications to be processed by the Bank of England, while ensuring continuity of access for UK firms to relevant EEA systems immediately after exit day. The SI also grants the Treasury the power to extend that period, should the Bank of England need more time.

The Treasury has been working very closely with the Bank of England and the Financial Conduct Authority in drafting this instrument. The Treasury published the instrument in draft, alongside explanatory notes to maximise transparency to Parliament, industry and the public, on 31 October 2018. The Treasury has engaged with the financial services industry, in particular systems, on the SIs and will continue to do so going forward. Last Wednesday the Treasury also published the impact assessment that accompanies the SI. The impact assessment confirmed that there is no impact to UK firms as a result of bringing forward this legislation. However, there will be costs to EEA firms,

which will need to familiarise themselves with the UK regime and pay fees to the Bank of England in order to be designated.

In conclusion, the Government believe that this legislation is necessary to ensure the smooth functioning of financial markets in the UK, if the UK leaves the EU without a deal or an implementation period. I hope colleagues will join me in supporting the draft regulations, which I commend to the Committee.

2.36 pm

Jonathan Reynolds (Stalybridge and Hyde) (Lab/Co-op): It is a pleasure to serve under your chairmanship, Sir Christopher. Once again the Minister and I are discussing a statutory instrument that would make provision for a regulatory framework after Brexit in the event that we crash out without a deal. On each of these occasions, as the Minister knows well, I and my Opposition Front-Bench colleagues have spelled out our objections to the Government's approach to secondary legislation.

The volume of EU exit secondary legislation is deeply concerning for accountability and proper scrutiny. The Government have assured the Opposition that no policy decisions are being taken. However, establishing a regulatory framework inevitably involves matters of judgment and raises questions about resourcing and capacity. Intrinsic decisions are being made on a daily basis now about supervisory arrangements, and we do not believe that is the correct process for ensuring the scrutiny required for measures of this kind.

Today we turn our attention to the draft financial markets and insolvency provisions. The regulations serve an important purpose in ensuring the stability of our overall financial market infrastructure in the event of insolvency, so there must be due care and attention paid to carrying those safeguards into domestic legislation. Replacing EEA references with UK ones sounds relatively straightforward. However, I would like to ask the Minister some questions about the bestowal of powers on the Treasury and about the establishment of the temporary designation regime, which I will refer to as the TDR, both of which are brought about by the SI.

According to a "Dear CEO" letter sent to relevant companies by the Bank of England in July 2018, those companies were advised to prepare for a TDR and begin a pre-application process. However, it is not clear whether the TDR we are debating today applies to one that will exist solely in the event of no deal, or whether this is an interim plan for a transition period. Whichever is the case, this seems extremely late to be establishing such a framework.

The Minister and I debated the establishment of a temporary permissions regime back in October, to give firms sufficient time to apply for it, but our exit from the European Union is now next month. How does the Minister propose that companies will have enough time to apply, or that the Bank of England will have sufficient capacity to deal with the likely volume of incoming applications, along with those for the temporary permissions regime?

I note in the draft regulations that notification must have been made prior to exit day of the intention to apply for temporary permission. Does the Treasury or the Bank of England have an estimate of how many participants are likely to apply under the TDR? How will the TDR operate and where is that outlined? From the Minister's speech, it sounded as though it would perhaps be applicable only to firms that are already recognised, but I am unsure of that point and would be grateful for clarity on it.

The instrument also confers on the Treasury the power to extend the TDR as it sees fit. The Opposition's concern is that that is granting an indefinite authority. Will the Minister explain why that is necessary? It would seem much more appropriate and democratic to include a sunset clause on such powers, to ensure appropriate checks and balances.

For that reason, this feels like one of the more blunt statutory instruments that we have discussed in relation to providing for a no-deal framework. I am quite concerned about that, but I would like to give the Minister the opportunity to respond to some of those concerns and give us some insight into those matters, before probing slightly further.

2.39 pm

Kirsty Blackman (Aberdeen North) (SNP): I thank the Minister for ensuring that an impact assessment was provided to us in advance. We have not always had one, and I am pleased that we do today. I found it incredibly helpful in preparing for the Committee, and in understanding the legislation and the impact the Government expect it to have. That was very useful.

The information that the Government have provided to us, particularly in the explanatory memorandum, still says that they believe that no deal is incredibly unlikely. The explanatory memorandum says of no deal that

"the government does not anticipate it arising."

I understand that the explanatory memorandum was written back in October. I wonder whether the Minister is keen to update its phraseology so it is more in tune with the Prime Minister's current views, given that no deal seems much more likely than it did around October.

I have a few concerns with the statutory instrument, some of which were covered by the hon. Member for Stalybridge and Hyde. The SI seeks to vary the powers of the Bank of England. It seems to me that that is a significant change. Any variation of the powers of the Bank of England should probably be discussed by the House in a bigger forum than a Delegated Legislation Committee. Whether the power of the Bank of England needs to be extended in this way to cover any transitional period is quite a serious matter, which probably needs to be looked at in the round, perhaps by the Treasury Committee.

The hon. Gentleman's point about the power of the Treasury is incredibly important. Giving the Treasury unfettered power to extend the period is concerning, and that is certainly not something that I would be particularly happy to support. The Minister mentioned that the draft SI and the explanatory memorandum were published back in October. I would be interested to know—I have asked this before, so the Minister should expect me to ask this question—whether there were any hits on the website for the draft SI. There is no point in the Government putting it on a website if nobody looks at it, because then it is not fulfilling its purpose as a consultative document.

[Kirsty Blackman]

If people did look at the SI, did they comment on it? I understand that consultation was undertaken only with the FCA and the Bank of England, rather than more widely. That is certainly what the explanatory memorandum says. Did anybody else have any input into that consultation, to raise issues or make positive comments about the statutory instrument? Has the statutory instrument been changed since it was published in draft? I expect that if people had responded to the consultation with concerns, the draft statutory instrument could have been changed to take account of those concerns, so it would be useful to know whether any changes were made.

On the transitional designation, 126 EU systems currently benefit from protection under the settlement finality directive. According to the impact assessment,

"as of 24 January 2019, 26 systems have indicated their intention to enter the UK post exit regime."

Presumably those 26 systems have done something to start the process for transitional protection, which is quite impressive considering that the transitional scheme does not yet exist.

How many of those 126 organisations have actually been contacted by the Bank of England? Has the Bank of England contacted all of them? Are they aware that they will need to do something in advance of 29 March, if things go ahead as envisioned? If they are not aware, why is the Treasury not asking the Bank of England to contact them to make them aware of their requirement to do that? We are very close to 29 March now. It would be sensible for those organisations to be aware that they have to notify their intention before exit day to take part in the transitional scheme, and that they then have to make a full application within six months. That would be incredibly useful.

There are a few more things I would like to raise. The hon. Member for Stalybridge and Hyde mentioned the issues with the Government saying they are not making policy decisions through the delegated legislation being made under the European Union (Withdrawal) Act 2018. It seems to me that the Government have made a very significant policy decision by not recognising things that are recognised in EU states by EU authorities. It seems to me that the Government have at no stage put it to Parliament that that is their policy position in all the delegated legislation coming through.

I am on the European Statutory Instruments Committee and we see a lot of statutory instruments coming through where the UK has decided unilaterally not to recognise EU qualification designation systems. There seems to be no clarity about which ones are not recognised and whether any will be recognised. Obviously, in this case, the Government are building in a transitional protection to recognise some things that have been recognised by EU authorities for a brief period. However, I have not seen that in any of the other instruments that have come forward. I am not clear whether that is a Government policy. It would help us all as parliamentarians to understand why the Government have taken a decision unilaterally, when the EU has not changed any legislation, not to recognise things on day one that have been recognised as appropriate under the current system. More information on the Government's position on that would be incredibly useful.

I am concerned about not recognising those designations, because the EU has not changed its law and will not do so overnight on 29 March. Presumably, those regulatory regimes will not change overnight on 29 March, so they should still be appropriate. The more sensible legislative approach would be to continue to recognise those designations and, in the event of the EU or the UK making changes to its regulatory regime, to bring forward another SI or in some cases primary legislation to change that recognition, and to refuse to recognise those agreed under EU authority. The Government seem to have it backwards; this is certainly not how I would have done it if I were making these decisions.

Whatever happens, it is important that the SI works and there is continuity for the people and organisations that benefit from these protections. I understand that, in setting up transitional designation, the Government are trying to ensure that that happens. I am concerned about the lack of consultation. I get it that the Government have consulted the Bank of England and the FCA, but more consultation or evidence of consultation with the organisations affected would have been helpful. It would have been useful if the Government had come forward with that information.

What I am most concerned about is ensuring that transitional designation is fit for purpose—that the people who should use it can do so and are aware of their obligations, so that people are protected. I am also particularly concerned that the Treasury is being granted powers that I am not keen it should be granted without a sunset clause—that is a great idea—and that the Bank of England is being granted powers that I feel should be discussed in a bigger forum than a DL Committee. An awful lot of DL Committees are going on, so some Members might have missed the fact that this incredibly important Committee was happening and been unable to come along and say, "I'm not particularly happy about the way that this is being done."

It would be useful if the Minister provided answers to some of those points. Depending on his answers, we might need to vote against the SI.

2.49 pm

John Glen: I thank the hon. Members for Stalybridge and Hyde and for Aberdeen North for raising those issues. I will start with the Opposition Front-Bench spokesman's opening comments. He questioned the appropriateness of our journey through these many SIs. It is profoundly concerning to me that we have such a high volume to deal with every week. All I can do is ensure that the work has been done on the impact assessments, and that the engagement with industry has been thorough and its concerns responded to. I reassure him that, clearly, we are within the scope of the powers under the legislation.

Hon. Members asked a number of specific questions, which I shall try to address. The hon. Gentleman expressed concern about the provision being applicable only in a no-deal situation. I can confirm the SI is just for a no-deal scenario. The temporary designation regime allows EEA systems that currently benefit from UK protections under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 by virtue of the UK's membership of the EU to continue to do so after exit. As the hon. Member for Aberdeen North pointed out, the Bank of England clarified on 24 January which have already expressed a desire to join.

Kirsty Blackman: Can the Minister explain whether, in the event of the Prime Minister's deal getting through and there being some sort of implementation period, he envisages a transitional regime or whether everything will just go ahead as it is currently?

John Glen: I am very happy to respond. In the situation that we have a deal, which is what the Government wish to happen, we would enter the implementation period. That means we would have continuity of current arrangements until we secured the enhanced equivalence solution, which we would be working towards, by the middle of next year, before the end of the implementation period.

The hon. Member for Stalybridge and Hyde expressed concern about the cost. We estimate that 126 EEA firms benefit from UK protections via the SFD and would therefore be in scope for this regime. Each firm is expected to have a one-off familiarisation cost of £210, so the total cost would be £27,000.

The hon. Member for Aberdeen North asked about the extension of the Bank's power to designate non-EEA systems, which she posited was a significant policy change to the EU SFD and therefore incompatible with the general onshoring approach. The key point is that if, in the undesirable circumstances that we leave the EU with no deal, the UK becomes a third country and therefore is treated the same as any other non-EU jurisdiction, the new regime would need to reflect that. The SFD is a directive rather than a regulation and so allows for a degree of member state discretion on transposition into national law. I suspect that is why there is the impression of some arbitrary decision being taken.

A number of member states, including the UK, have in place or are working towards a framework for designating non-EEA entities. I would therefore submit that the Bank's power to designate non-EEA systems is not a significant policy change from how the SFD framework currently operates in the EU at member state level. I note the hon. Lady's observations about how her approach would differ, in that, if changes were made to the EU directive, we would submit another SI. I cannot give her the explicit rationale for why we did not adopt that approach, but I am happy to write to her on that point.

The hon. Lady also raised concerns about who had looked at the SI and asked about hits on the website. I do not have that data. I do not know whether it has been collected; I do not think it has. We engaged with stakeholders, including the financial services industry, while drafting these SIs, and they were published in advance. We shared the draft legislation with industry to allow stakeholders the opportunity to familiarise themselves with our approach and to test our understanding of the impact, and it was welcomed and supported. I cannot give the hon. Lady a precise answer about the iterations leading to the final SI being laid before the House, but I can say that there are no concerns about where it has ended up.

The hon. Lady asked about my view on the likelihood of no deal and whether it has changed. Obviously, we cannot completely rule out the possibility that the UK will leave the EU without a deal, but from my perspective as a junior Treasury Minister, it is important that I deliver a fully functioning legislative and regulatory regime come what may, and that is what I am determined to do. We have engaged with stakeholders to ensure that happens. The Commons continues to debate and, I hope, approve SIs relating to no deal, but I think the process the Government are going through is well known.

The hon. Member for Stalybridge and Hyde asked what the procedure would be for extending the temporary designation regime. Under this instrument, the Treasury will be able to extend the temporary designation regime by an additional 12 months beyond the initial three-year period. We would do that by laying a negative SI, given that we would not be substantively changing anything; it would be an administrative change. We would lay a written ministerial statement before both Houses in advance of laying that SI, in order to inform them of the situation.

Jonathan Reynolds: I suspect that the Minister may need some inspiration to answer this question, but could that be a cumulative process? Could it be used only once, or could a series of annual negative SIs be laid to prolong the process in perpetuity?

John Glen: I am grateful for the advice I have received, mystically, from behind me. It could be a multiple approach, but, again, that would be justified in the written ministerial statement. It is quite difficult to see how that would go on in perpetuity, but if there was a justification from the Bank of England, that would be made clear and that would happen.

Kirsty Blackman: As the Minister managed to get divine inspiration for that question, he might manage to get some for this one. He has talked about the cost to companies of having to make these changes and go through the registration process. I failed to ask about, and the Minister did not mention, the additional cost that the Bank of England might incur from administering the transitional designation regime.

John Glen: I am very happy to write to the hon. Lady about that. I think the cost would be minimal, and it would be in the context of the Bank's overall work. I do not know whether the cost relevant to this directive can be isolated, but I will write to her in general about the resourcing of the work of the Bank of England.

The hon. Lady also asked whether the Government have decided not to recognise systems that are recognised by EU authorities. The mutual recognition process works by virtue of the UK being a member state and hence subject to the settlement finality directive. I may have raised this point earlier. When we leave the EU, we will no longer be subject to the SFD, so this is not a policy decision; it is a necessity to provide continuity in respect of EEA systems. That is why the temporary designation regime is being created.

There is also the question of our overall aspiration. Clearly, we hope to secure a deal, and therefore we have ambitious plans subsequent to that, during the implementation period, to have an ambitious arrangement with the EU where we have strong relationships, regulator to regulator. This SI is essential for ensuring that we continue to have an effective framework for financial markets insolvency in the UK in a no-deal scenario. I hope this sitting has been informative and that the Committee will join me in supporting this SI.

Question put and agreed to.

2.58 pm

Committee rose.