# PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

Eighteenth Delegated Legislation Committee

# DRAFT TRANSPARENCY OF SECURITIES FINANCING TRANSACTIONS AND OF REUSE (AMENDMENT) (EU EXIT) REGULATIONS 2019

*Wednesday 27 February 2019*

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**not later than**

**Sunday 3 March 2019**

**The Committee consisted of the following Members:**

*Chair:* PHILIP DAVIES

† Chishti, Rehman *(Gillingham and Rainham)* (Con)
† Dowd, Peter *(Bootle)* (Lab)
† Fitzpatrick, Jim *(Poplar and Limehouse)* (Lab)
† Glen, John *(Economic Secretary to the Treasury)*
† Hendry, Drew *(Inverness, Nairn, Badenoch and Strathspey)* (SNP)
† Jayawardena, Mr Ranil *(North East Hampshire)* (Con)
† Knight, Sir Greg *(East Yorkshire)* (Con)
† Knight, Julian *(Solihull)* (Con)
† Lord, Mr Jonathan *(Woking)* (Con)
† Pow, Rebecca *(Taunton Deane)* (Con)
† Smith, Jeff *(Manchester, Withington)* (Lab)
† Spellar, John *(Warley)* (Lab)
Streeting, Wes *(Ilford North)* (Lab)
† Thomson, Ross *(Aberdeen South)* (Con)
† Timms, Stephen *(East Ham)* (Lab)
† Walker, Thelma *(Colne Valley)* (Lab)
† Whittaker, Craig *(Lord Commissioner of Her Majesty's Treasury)*

Peter Stam, *Committee Clerk*

**† attended the Committee**

# Eighteenth Delegated Legislation Committee

*Wednesday 27 February 2019*

[Philip Davies *in the Chair*]

## Draft Transparency of Securities Financing Transactions and of Reuse (Amendment) (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 Transparency of Securities Financing Transactions and of Reuse (Amendment) (EU Exit) Regulations 2019.

May I start by saying what a pleasure it is to serve under your chairmanship again, Mr Davies? The draft regulations—like the draft Securitisation (Amendment) (EU Exit) Regulations 2019, which were debated this morning—are part of our programme of legislation under the European Union (Withdrawal) Act 2018 to ensure that if the UK leaves the EU without a deal or an implementation period, there will continue to be a functioning legislative and regulatory regime for financial services in the UK.

The draft regulations will fix deficiencies in EU law on securities financing transactions to ensure that it continues to operate effectively after the UK leaves the EU. They are aligned with the approach taken in all 52 of the statutory instruments that I have laid before Parliament under the 2018 Act: providing continuity by maintaining existing legislation at the point of exit, but amending it where necessary to ensure that it works effectively in a no-deal context.

The draft regulations concern securities financing transactions, in which securities such as equities are used to borrow cash or vice versa. A common type of SFT is a repo—repurchase transaction—in which a party sells an asset to another party at one price and commits to repurchasing it at a different price on a later date. SFTs were not regulated before 2015; there were major concerns about their effect on the economy, especially because during the financial crisis repurchase transactions were associated with increases in leverage and exacerbating boom and bust cycles in the economy.

After the Financial Stability Board identified significant risks associated with such instruments, the EU passed the securities financing transactions regulation to introduce a framework under which details of SFTs must be reported to trade repositories, which are effectively databases for reporting transactions. Under the regulation, such information must then be disclosed to investors, and national regulators are required to act where they identify risky practices by firms.

The regulation is therefore crucial to protecting financial stability and ensuring that the benefits of SFTs remain available to firms that use them and to the wider economy. On exit day, it will be transferred to the UK statute book under the 2018 Act. In a no-deal scenario, however, the UK would be outside the European economic area and outside the EU's legal, supervisory and financial regulatory framework, so the legislation would no longer be operative.

The draft regulations will make the necessary amendments to ensure that the relevant provisions continue to work properly in a no-deal scenario. First, they will amend the treatment of EEA branches of financial services firms in the UK, so that after the UK leaves the EU, EEA branches operating in the UK must report their transactions to a UK trade repository. That means that they will be treated in the same way as other third-country branches operating in the UK, which is consistent with the approach that we have adopted in other financial services SIs laid under the 2018 Act.

Secondly, the draft regulations will amend the list of entities that have access to data on securities financing transactions reported to UK trade repositories. EU bodies will be removed, making the list UK-specific to reflect the UK's status as a third country outside the EU in a no-deal scenario. That will not preclude UK entities from co-operating with EU entities in future.

Finally, the draft regulations will transfer to the Financial Conduct Authority the European Securities and Markets Authority's responsibilities relating to the requirements for the registration of trade repositories, and will amend the rules so that they continue to work in a domestic context. That is appropriate, given the FCA's current role in supervising and regulating SFTs.

Because of limitations in the powers available under the 2018 Act, one of the main provisions of the securities financing transactions regulation cannot be domesticated at this stage: the requirement for firms to report details of SFTs to trade repositories. Depending on the type of institution concerned, that requirement will not apply until 12 to 21 months after the EU's publication of relevant regulatory technical standards. Those standards have not yet been published, so the requirement could not be included in the draft regulations, since it will not be

"operative immediately before exit day",

in the wording of the 2018 Act. However, we have introduced separate legislation—the Financial Services (Implementation of Legislation) Bill, or "in-flight files Bill", which had its Committee stage yesterday—to ensure that the requirement will apply in a domestic context in due course.

In drafting the regulations, the Treasury has worked closely with the Prudential Regulation Authority and the Financial Conduct Authority. We have also engaged with the financial services industry, and we will continue to do so. On 19 December, we published the regulations in draft, with an explanatory policy note to maximise transparency to Parliament and industry. Prior to publication, we shared a draft with the industry for technical analysis, and we incorporated its feedback into the final draft.

In summary, the Government believe that the draft regulations are necessary to ensure that the UK has a workable regime for securities financing transactions, and that the legislation will continue to function appropriately if the UK leaves the EU without a deal or an implementation period. I hope that colleagues across the parties will join me in supporting the draft regulations. I commend them to the Committee.

2.37 pm

**Peter Dowd** (Bootle) (Lab): It is a pleasure to see you in the Chair, Mr Davies. Once again, the Minister and I are in a Committee Room discussing a statutory instrument that would set up a regulatory framework after Brexit in the regrettable event that we parachute out of the EU without a parachute. On each such occasion, my Labour Front-Bench colleagues and I have explained our objections to the Government's approach to secondary legislation. The Minister referred to financial stability, but the best way to maintain financial stability would be through continued access to a customs union and a single market—that is a hint that he may wish to take to the Chancellor.

The volume and flow of secondary legislation on EU exit raises deep concerns about accountability and proper scrutiny—I have just raised a very similar matter in the main Chamber. The Government say that no policy decisions are being taken, but establishing a regulatory framework inevitably involves policy and raises questions about resourcing and capacity, as we have heard many times. The Government should be using secondary legislation to make technical, non-partisan and uncontroversial changes, but they are persistently using it to push through contentious legislation with high policy content.

As legislators, we have to get this right. The draft regulations could represent major changes to the statute book, so they need proper, in-depth scrutiny. In that light, the Opposition put on the record our deepest concerns that the process behind them is not as accessible and transparent as it could be, or as the Minister suggests.

The draft regulations will introduce into UK law a regime for securities financing transactions. They set out a process to allow the Financial Conduct Authority to suspend reporting obligations for up to a year. It would be useful to understand the logic of the one-year period. What assessment has been made of the subsequent impact on transparency standards?

Regulation 8 will give the Bank of England and the FCA powers to draft technical standards. Has any consideration been given to allowing Parliament to undertake that role or giving it greater oversight? It is not completely clear—I would be grateful for clarification from the Minister—why the requirement for the ESMA to draft certain regulatory standards is being replaced with the option for the FCA to do so. In particular, will he assure us that the draft regulations are not being used to dilute democratic accountability?

Regulation 23 will give the Treasury the power to make more secondary legislation. I would like the Minister to provide more information on that, if possible, especially in relation to scope and accountability.

Part 4 of this SI makes provision for trade repositories, which is a different subject with different EU regulation. The SI seems to allow the FCA to issue new penalties. The Opposition feel that that is not the sort of thing that should be done through an SI. We note that the FCA has been asked to issue a statement of policy for penalties, but surely that should have been done before the SI was introduced, not afterwards. That seems perfectly reasonable. The explanatory memorandum states that these regulations include:

"Changes to the treatment of EEA branches of financial services firms in the UK, so that after exit, EEA branches operating in the UK must report their transactions to a UK trade repository. This will bring treatment of EEA branches into line with the current treatment of other third country branches in the UK."

I would be grateful to hear more from the Minister about that. For example, could it represent a change to regulatory standards? That would be quite worrying. I note that the explanatory memorandum refers elsewhere to

"reporting the same data on the same templates, but to two separate trade repositories."

Again, I seek clarification on whether there could be any changes to such a template.

The explanatory memorandum also states:

"Given the highly regulated nature of financial services, the volume of trade between UK and EU markets, and a shared desire to manage financial stability risks, the UK proposes a new economic and regulatory arrangement that will preserve mutually beneficial cross-border business models and economic integration for the benefit of businesses and consumers. Decisions on market access would be autonomous in our proposed model, but would be underpinned by stable institutional processes in a bilateral agreement and continued close regulatory and supervisory cooperation."

The use of the word "new" does not suggest continuity. Similarly, the phrase "preserve mutually beneficial" suggests some element of selection and discretion. It will not surprise the Minister to learn that the Opposition do not always share the Government's analysis of what is beneficial for our economy or our constituents. I would be grateful if the Minister elaborated on the planned "autonomous" nature of the decisions on market access.

Why are parts still highlighted on pages 6 and 7? Is that a drafting error? Is it a sign of the hurried chaos of the process? As the Opposition have made clear numerous times, this process is unprecedented in its scale and scope, and there are unquestionably many areas that have received insufficient scrutiny. The potential for problems to be discovered only after the fact is very real. In fact, on Monday it was rightly acknowledged that there had been mistakes in the drafting of the Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019. Last week, the Financial Regulators' Powers (Technical Standards etc) and Markets in Financial Instruments (Amendment) (EU Exit) Regulations 2019 had to make technical amendments to correct measures passed just last December—not years ago, but pretty recently. I have to say that we opposed those regulations and called for greater scrutiny of them.

The Minister knows that we have identified drafting errors in other SIs that have been presented to us. Indeed, during a Committee sitting last week in the other place, the Conservative peer Lord Lexden voiced concerns about the number of drafting errors in instruments. I want to make it clear that I do not believe that this is the fault of civil servants, who are working enormously hard on this package of legislation in extremely difficult circumstances—they have a Herculean task. The fault is in the process. The Government are recklessly pushing through the process with incredible short-termism and a lack of respect for the magnitude of the task and for Parliament in general.

I note that the ESMA is having its responsibilities shifted to the FCA through regulations. I am forced, once more, to give voice to our concerns and queries about this unprecedented transfer of powers via secondary

*[Peter Dowd]*

legislation. What consultation has there been on this transfer? Were other institutions considered? What resourcing has been provided? Has the Minister considered the possibility that too many powers are being given to the FCA—more than is practical?

The Opposition have repeatedly stated our increasing alarm at the Government's unfolding approach to regulating financial services: still no overall plan, still no indication of how different pieces fit together and still, above all, no clarity. I put on the record again that the Government are continuing to put the economy at risk through their shambolic handling of Brexit. Rather than pushing through such a large volume of piecemeal secondary legislation, we clearly need a consolidated piece of primary legislation that can be scrutinised in the proper way.

I know that the Government do not like a great deal of scrutiny and go out of their way not to enable it—well, there we are—but it does not alter the fact that that is what we are asking for. The regulations will transfer far too much power, have possible ramifications that are too significant, and they are shrouded with too many unanswered questions. We cannot in conscience just wave through something like this. Therefore, we do not feel that it would be responsible to agree that the Committee has considered them adequately today.

2.46 pm

**Drew Hendry** (Inverness, Nairn, Badenoch and Strathspey) (SNP): It is a pleasure to serve under your chairmanship, Mr Davies. This is yet another part of a poor attempt to patch up the damage to the financial services industry caused by a Brexit that my constituents, and indeed all of Scotland, did not vote for. It is just another piece of Brexit red tape. Any version of Brexit is bad for Scotland, which voted overwhelmingly to remain.

Financial services firms are already voting with their wallets and have moved a trillion dollars from the UK since the 2016 Brexit referendum. Ten years after the financial crash, in which securities played a major role, our financial services sector needs meaningful reform, not new problems stemming from Brexit. Instead of planning to minimise the damage, we should be using our time to plan a successful future inside the EU. This SI does nothing to protect our economy from Brexit and we cannot accept the UK Government's attempt to run down the clock in an attempt to force their MPs to back Brexit motions. The UK Government must instead extend article 50.

2.47 pm

**John Glen:** I very much respect the points made by the hon. Members for Bootle and for Inverness, Nairn, Badenoch and Strathspey. I will respond to each of the 10 or 11 points that have been raised in succession. The opening remarks of the hon. Member for Bootle concerned the process with respect to the volume and flow, the adequacy of the resourcing, the capacity and transparency.

I will address all of those points, but I will say that the SI is needed to ensure that the EU law on securities financing transactions continues to operate effectively if we leave without a deal or an implementation period. It is not the policy of the Government to get to that point, because we are seeking a bilateral agreement with the EU that would expand the scope of cross-border activity beyond existing equivalence and ensure structured dialogue to manage regulatory change. Our proposal for a future UK-EU relationship in financial services seeks to be both negotiable and ambitious, but it is obviously prudent and necessary for us to have no-deal preparations such as these.

The hon. Member for Bootle commented on the onshoring project and the powers used. The 2018 Act does not give the Government the power to make policy changes, as has been spelled out in this SI, beyond those needed to address deficiencies arising as a result of exit. They are limited and seek simply to onshore existing provisions into domestic regulators and fix deficiencies as they exist.

The hon. Gentleman then referred to the reliance on secondary legislation. Those of us who have sat through a number of such Delegated Legislation Committees in recent weeks, including the Whip, my hon. Friend the Member for Calder Valley (Craig Whittaker), all recognise that, under the powers granted by 2018 Act to make all these financial services statutory instruments, restrictions are in place to ensure the appropriateness of their use. The central objective of the SIs is to provide, as far as possible, legislative continuity for firms. No policy changes are intended; the exercise is an intelligent onshoring one.

**Mr Ranil Jayawardena** (North East Hampshire) (Con): May I probe the Minister a little further? He talks of onshoring policy, not changing it. The FCA is picking up a number of different roles under the draft regulations, particularly on enforcement, so will he assure us that there will be no resulting policy deviation in relation to the penalties that might be imposed?

**John Glen:** I am happy to say that the FCA has been intimately involved in the whole process. Its objective is to provide continuity to the market and to ensure that appropriate scrutiny of market activities is undertaken. No extension of power is given to the FCA through this process. As the national competent authority, it is simply taking on more responsibilities that were often elsewhere previously.

**Mr Jayawardena:** I thank the Minister for that answer. May I probe further? Given that the FCA is taking on those responsibilities, is it recruiting more people to undertake that work? If so, is it making good progress in doing so?

**John Glen:** Yes. I can tell my hon. Friend that, for example, 158 individuals or full-time equivalents in the FCA are now working on Brexit matters, which contrasts with 28 such individuals or full-time equivalents in March last year. It will shortly be setting out its plan for 2019-20, which will set out how it is allocating resources. The FCA has the power to increase the levy should it require additional resources.

I have sought to address the issue of the reliance on secondary legislation with the inherent restraints placed on the Government in the process. The hon. Member for Bootle went on to ask whether the change in the SI

to how branches are treated will lead to duplicative requirements for firms, but firms are simply reporting the same information at the same time using the same template to the UK and EU authorised trade repositories, so yes, there is duplication, but it is straightforward—exactly the same form is sent to two institutions simultaneously.

The hon. Gentleman asked about the suspension of reporting for one year. The draft SI, like other financial services SIs, does not make changes beyond what is necessary to ensure that we have a functioning regime after exit. With regard to the powers to make regulatory technical standards, that reflects an approach that applies across the entire body of onshored legislation. In addition, the SI will ensure that regulators have sufficient flexibility to avoid cliff-edge risks for firms.

The hon. Gentleman asked about the robustness of the SIs and drew attention to the admission that I made on Monday on the Floor of the House about some minor typographical drafting errors, including one or two that happened previously. There are, I think, 1,000 pages of the SIs. My officials and I have done our best, we have acknowledged where those mistakes were made, and we have corrected them as quickly as we could, but they were not meaningful in their substantive legal effect, with the exception of one case, which has now been corrected. We have engaged with industry on the content of the SIs. We usually—I cannot remember circumstances in which we have not—publish the drafts of the SIs in advance of laying them before Parliament, and we have allowed an iterative process to exist.

The hon. Gentleman asked, in connection with regulation 4, whether we should use an SI to allow the FCA to issue penalties. The 2018 Act allows that in limited circumstances, with safeguards, including the affirmative procedure. The FCA needs the power properly to supervise trade repositories. He then asked about resourcing, but I have discussed that in response to my hon. Friend the Member for North East Hampshire.

The hon. Member for Bootle also asked about consultation. We published a document in June that set out our approach and emphasised the aim of ensuring continuity. That was widely welcomed. The draft regulations were published on 19 December, so people have had two months to examine them.

On the unavailability before the debate of a consolidated text, it is not normal practice for the Government to provide consolidated texts for debates on secondary legislation. I think that the hon. Gentleman was making a wider point about the overall need for all financial regulations. Frankly, that would be very difficult to achieve, given the wide range of contingency arrangements that are needed. However, the National Archives will publish an online collection of documents capturing the full body of EU law as it stands on exit day.

The SNP spokesman, the hon. Member for Inverness, Nairn, Badenoch and Strathspey, made a point about the volume of capital moving outside the UK and asked what the Government's response was to that. The Treasury is in frequent contact with firms and regulators about their contingency planning for EU exit. Although we have been clear that passporting will come to an end after we leave the EU, we are seeking a relationship with the EU that allows for continued cross-border trade in financial services, as set out in the White Paper. Although I acknowledge that there has been movement of some capital and execution of contingency arrangements, there is a great deal of resilience to the City of London and financial services in the United Kingdom. We need to draw a distinction between wholesale movement of jobs, and capital being located somewhere else but still being acted upon in the United Kingdom and the City of London.

The hon. Member for Bootle asked about discretion for mutual co-operation arrangements and market access. The Government's priority is to exit the EU with a deal that ensures continued co-operation with EU institutions on all regulatory matters, including SFTs. However, we are working hard to ensure that, in the no-deal scenario that we are seeking to cover ourselves for, we can maintain a degree of co-operation with the EU. Like all such SIs, the draft regulations ensure that we are prepared for all scenarios.

I believe that I have answered the points that were raised. I recognise the wider political point about the adequacy of this process, but I hope that Members have found this Committee sitting informative, will respect the answers I have given and will be able to support the draft regulations.

*Question put.*

*The Committee divided:* Ayes 9, Noes 7.

**Division No. 1]**

**AYES**

| | |
|---|---|
| Chishti, Rehman | Lord, Mr Jonathan |
| Glen, John | Pow, Rebecca |
| Jayawardena, Mr Ranil | Thomson, Ross |
| Knight, rh Sir Greg | Whittaker, Craig |
| Knight, Julian | |

**NOES**

| | |
|---|---|
| Dowd, Peter | Spellar, rh John |
| Fitzpatrick, Jim | Timms, rh Stephen |
| Hendry, Drew | Walker, Thelma |
| Smith, Jeff | |

*Question accordingly agreed to.*

2.59 pm

*Committee rose.*