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Public Bill Committee

FINANCIAL SERVICES BILL

Eighth Sitting

Thursday 26 November 2020

(Afternoon)

CONTENTS

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Monday 30 November 2020

The Committee consisted of the following Members:

Chairs: Philip Davies, † Dr Rupa Huq

† Baldwin, Harriett *(West Worcestershire)* (Con)
† Cates, Miriam *(Penistone and Stocksbridge)* (Con)
† Creasy, Stella *(Walthamstow)* (Lab/Co-op)
† Davies, Gareth *(Grantham and Stamford)* (Con)
† Eagle, Ms Angela *(Wallasey)* (Lab)
Flynn, Stephen *(Aberdeen South)* (SNP)
† Glen, John *(Economic Secretary to the Treasury)*
† Jones, Andrew *(Harrogate and Knaresborough)* (Con)
† McFadden, Mr Pat *(Wolverhampton South East)* (Lab)
† Marson, Julie *(Hertford and Stortford)* (Con)
† Millar, Robin *(Aberconwy)* (Con)
† Oppong-Asare, Abena *(Erith and Thamesmead)* (Lab)
† Richardson, Angela *(Guildford)* (Con)
† Rutley, David *(Lord Commissioner of Her Majesty's Treasury)*
† Smith, Jeff *(Manchester, Withington)* (Lab)
† Thewliss, Alison *(Glasgow Central)* (SNP)
† Williams, Craig *(Montgomeryshire)* (Con)

Kevin Maddison; Nicholas Taylor, *Committee Clerks*

† attended the Committee

Public Bill Committee

Thursday 26 November 2020

(Afternoon)

[Dr Rupa Huq *in the Chair*]

Financial Services Bill

2 pm

The Chair: The same drill as the other day: I am happy to permit Members to remove their jackets. Apparently permission has to be sought from the Chair to remove a jacket, so there you go—that is how nice I am. I saw you a lot on TV yesterday, Minister; it is nice to see you in the flesh.

Clauses 14 and 15 ordered to stand part of the Bill.

Clause 16

Review of exercise of powers under Article 23D

The Economic Secretary to the Treasury (John Glen): I beg to move amendment 3, in clause 16, page 23, line 13, leave out "latest" and insert "most recent previous".

This amendment clarifies what the FCA has to review before re-exercising the power under Article 23D(2) of the Benchmarks Regulation.

Clause 16 introduces a new provision: article 23E of the benchmarks regulation. It requires the Financial Conduct Authority to conduct and publish a review of an exercise of its article 23D powers to direct the administrator of an article 23A benchmark to change the methodology rules, or code of conduct, of the benchmark. Where the FCA has exercised a power under article 23D, the FCA is required to conduct and publish a review of the exercise of that power two years after the power is first exercised. The FCA must then conduct and publish such a review in each subsequent two-year period until the benchmark ceases to be published.

The FCA will also be required to review the exercise of this power under article 23D whenever it intends to re-exercise its power in relation to the same benchmark. The FCA must conduct and publish a review of the latest exercise of its article 23D power before re-exercising the power where that is reasonably practicable. In circumstances where it may not be reasonably possible for the FCA to conduct its review prior to the use of the power, the FCA must conduct and publish its review as soon as is reasonably practicable after the re-exercise of its article 23 power. For instance, it is possible that the FCA may need to take such a course of action when it needs to access its article 23D powers urgently to prevent significant market disruption or financial stability risks.

In concluding the review, the FCA will be required to consider whether the exercise of its power has advanced, or is likely to advance, its statutory objectives to protect consumers and market integrity. It must also have regard to the statement of policy that the FCA has published in respect of the use of its article 23D powers. The clause provides a statutory mechanism through which the effectiveness of the FCA's exercise of its powers under article 23D can be evaluated. It also serves to increase the accountability of the FCA in the exercise and re-exercise of the powers.

I apologise for not acknowledging you in the Chair, Dr Huq; it is a pleasure to serve under your chairmanship. I recommend that the clause stand part of the Bill.

Mr Pat McFadden (Wolverhampton South East) (Lab): I thank you, Dr Huq, for chairing this afternoon's session. For clarity, we had a fairly extensive debate on clauses 13 to 16 together, hence the speed of our progress at the beginning of this session.

The Chair: Thank you.

John Glen: Amendment 3, which stands in my name, is a technical amendment. As the explanatory note says, it is intended to clarify the scope of the review that the FCA is required to undertake where it re-exercises its article 23D(2) powers in relation to the same benchmark. Article 23D(2) provides the FCA with the powers to direct the administrator of a critical benchmark to change the methodology rules or code of conduct of the benchmark. The amendment serves to put beyond doubt which exercise of power the FCA is required to review at this point in time.

I would like to address the point raised by the right hon. Member for Wolverhampton South East just before we broke for lunch on the international LIBOR transition. The Government have followed related global regulatory developments closely, including what is going on the United States, as he mentioned, with the US Alternative Reference Rates Committee's legislative proposal. We continue to work with regulators to engage our international counterparts directly, as well as through the Financial Stability Board's official sector steering group and the International Organisation of Securities Commissions.

It is quite clear that, as the right hon. Gentleman stated, we will need a co-ordinated global approach, and we aim to provide consistent outcomes for users. The Government are committed to ensuring that their dialogue with international counterparts continues, and aim to firmly limit any unhelpful divergence to outcomes. I hope it will be helpful for the Committee to have that put on the record.

Mr McFadden: I am grateful to the Minister; I suspect that is a harbinger of a Government amendment at some point, because of the debate we had on safe harbour provisions. If they are coming in in the US and the EU, I suspect, given what he has just said about marching together on this internationally, we may see an amendment from him on this at some point.

The Chair: It sounds like fine-tooth comb stuff this morning.

Amendment 3 agreed to.

Clause 16, as amended, accordingly ordered to stand part of the Bill.

Clause 17

Policy statements relating to critical benchmarks

Question proposed, That the clause stand part of the Bill.

John Glen: Clause 17 introduces a new provision, article 23F of the benchmarks regulation. This clause requires the FCA to publish statements of policy and to have regard to those statements when exercising certain new powers set out in the benchmarks regulation. The FCA is required to publish a statement of policy with respect to the exercise of this power to designate a critical benchmark as an article 23A benchmark. This is the designation the FCA can make where it determines that a benchmark's representativeness cannot be restored or maintained, or that there are good reasons not to restore or maintain representativeness.

The FCA must also publish a statement of policy with respect to the exercise of its powers under article 21A, which allow it to prohibit new use of a critical benchmark when the administrator of that benchmark has notified the FCA of its intention to cease providing the benchmark. The FCA is also required to publish a statement of policy in exercising its powers under article 23C, which allow it to permit certain types of legacy use of an article 23A benchmark by supervised entities. Finally, the FCA must also publish a statement of policy in exercising its power under article 23D, which allows the FCA to impose requirements on the administrator of an article 23A benchmark to change the methodology, rules or code of conduct of the benchmark.

The Bill states that the FCA's duty to prepare and publish those statements of policy can be satisfied before as well as after this legislation comes into force. On 18 November, the FCA published two consultations inviting industry feedback on statements, which ask for views on how the FCA intends to exercise its article 23A and article 23D powers granted under this Bill. It has also stated its intention to engage with industry stakeholders and international counterparts in the development of its statements of policy with respect to its powers under articles 21A and 23C.

This clause increases transparency regarding how the FCA will exercise certain new powers set out in the Bill to support the orderly wind-down of a critical benchmark. In developing statements of policy, the FCA will be able to engage with industry and international counterparts. The clause also requires the FCA to have regard to those statements when exercising its new powers, reducing uncertainty for market participants. Therefore, I recommend that the clause stand part of the Bill.

Mr McFadden: I just have a question about these policy statements. We have been through quite a lot about how the FCA will designate, compel and continue the submission of information and all the rest of it. What role do these policy statements play in all of that? Is the policy statement simply putting into law a requirement on the FCA to say why it has acted as it has, or is it, as part of what I think is behind some of the stuff in these clauses, insulating the FCA against the threat of legal action because of the possible effect on contracts? Is this a nice to have, best practice or is it something that helps to protect the FCA against the threat of litigation, which has been a thread through this discussion?

Ms Angela Eagle (Wallasey) (Lab): Obviously, this is a very technical area, to say the least. I just want to ask a couple of questions so that I can get my head round how the FCA will use the power. We have different regulators who could make different determinations as to what constitutes benchmarks going forward, and yet those benchmarks write contracts worth trillions of pounds and dollars into the future. Any arbitrage opportunity in the way that those contracts work could make some people very rich and ruin others. This will be decided as one goes along. Some of these contracts are being made, but some are already projected into the future.

To ensure that markets are not distorted and the potential for nefarious profit by some with insider information is minimised, we need reassurance about how the FCA will perform the task, particularly in its interactions with the other regulators. I am not sure what the Government's intention is, apart from saying they are going to liaise with other regulators. Is it the Government's intention that these benchmarks ought to be similarly designed and defined across different regulatory jurisdictions, since this is almost a currency, or are we seeking divergence here as well in order to perhaps increase our chances of being the place where some of this business is written?

Perhaps the Economic Secretary could reassure me on that, because the FCA's powers are pretty strong, but what is the intention? That might be in all of the many consultations, which I confess I have not read, so it might be set out there. If the Minister could put a little more on the record, we might at least have some certainty there, not least for Pepper *v.* Hart purposes.

John Glen: I thank the right hon. Member for Wolverhampton South East and the hon. Member for Wallasey for their observations. The hon. Lady demonstrates her experience and professionalism in being able to jump in on the first clause, having not been here this morning—no disrespect intended.

Ms Eagle: None taken.

John Glen: The point that the hon. Lady makes is absolutely clear. We need to ensure that the regulations are in line with global practices because the issue is global. The interconnectedness of financial services markets demands, as in the statement I made just now, that we work very closely with regulators in other jurisdictions. It is absolutely right that we learn the lessons that the right hon. Gentleman, in his work on the Parliamentary Commission on Banking Standards several years ago, drew attention to with respect to the appalling abuses in the market. This measure is designed to give us a framework and to give the FCA the powers to ensure that we have global best practice and no ambiguity.

2.15 pm

The right hon. Gentleman asked about the statements of policy and their use, and sought reassurance on how this system will work. They are published by the FCA to describe in more detail how it will interpret and exercise its supervisory and regulatory functions more transparently. Obviously, the FCA has stated its aspirations with respect to LIBOR and its intention to engage market participants in the development of the statements of policy. But this measure will provide greater clarity and certainty to market participants—given the sums involved in the contracts, the associated risks are significant—as to how the overarching legal framework will be operationalised to deliver the orderly wind-down of this benchmark, which is the only critical benchmark to which these provisions would presently apply.

The FCA will continue to engage with market participants—that means domestically and internationally—as well as with other international authorities. In developing the statements of policy, the

FCA will be able to consider the broad spectrum of views and determine the appropriate way in which its powers could be exercised.

I will say that I have been doing this job for nearly three years and I have received a considerable number of pieces of advice over that time, because this is such a complex problem to resolve well, as the industry will testify, but this measure is about ensuring continued evolution of transparent policy making in this area.

Question put and agreed to.

Clause 17 accordingly ordered to stand part of the Bill

Clause 18

Critical benchmarks provided for different currencies etc

Question proposed, That the clause stand part of the Bill.

John Glen: This clause introduces a new provision, article 23G, into the benchmarks regulation. The clause makes provision about critical benchmarks provided for different currencies, or for different maturities or periods of time. This type of benchmark is known as an umbrella benchmark. LIBOR, for instance, is an umbrella benchmark. It is published in five different currencies over seven different time periods, ranging from overnight to up to one year. Those five currencies and seven time periods are paired to form 35 individual LIBOR settings, referred to in the legislation as "versions" of the benchmark. An example of a version of LIBOR would be three-month US dollar LIBOR.

Paragraph 3 of article 23G sets out that specified articles of the benchmarks regulation will apply to umbrella benchmarks as if each version were a separate critical benchmark. Paragraph 4 sets out how provisions under paragraph 3 of article 21, paragraphs 1(a) and 2 of article 22A and paragraph 1 of article 23E of the benchmarks regulation are modified in relation to an umbrella benchmark.

The Treasury will be able to make, by regulations, provisions about the operation of the UK BMR in respect of umbrella benchmarks. The regulations must be made by way of the affirmative procedure.

This clause sets out that the FCA will be able to exercise certain new powers to support the orderly wind-down of a critical benchmark in different ways in relation to different versions of an umbrella benchmark. It also clarifies the existing operation of certain provisions of the benchmarks regulation and how the FCA's powers apply to versions of a benchmark. Those clarifications of the FCA's powers will be of aid in supporting the orderly wind-down of a critical benchmark. For example, where panel banks begin to withdraw their submissions to some or all versions of LIBOR after the end of 2021, the different versions of LIBOR are likely to become unrepresentative, as we discussed earlier, or be at risk of becoming unrepresentative at different speeds.

It would be neither practicable nor appropriate for the FCA to exercise its new and existing powers uniformly across all versions of LIBOR simultaneously. For example, it is possible that if the robust input data necessary for an alternative methodology is not clearly available for certain versions of LIBOR, the FCA may not be able to exercise its power to direct a change in its methodology. In other cases, market participants may prefer to cease publication of some LIBOR versions. The FCA will consider evidence and views from market participants and global authorities in deciding the best course of action in respect of LIBOR versions.

It is critical to the wind-down of LIBOR, and future umbrella benchmarks, that the FCA can apply its powers under this legal framework to different versions of an umbrella benchmark at different times and in different ways. I therefore recommend that this clause stand part of the Bill.

Question put and agreed to.

Clause 18 accordingly ordered to stand part of the Bill.

Clause 19

Changes to and cessation of a benchmark

Question proposed, That the clause stand part of the Bill.

John Glen: The clause introduces amendments to article 28 of the benchmarks regulation, including new paragraphs 1A to 1E. Article 28 of the benchmarks regulation stipulates requirements for benchmark administrators and supervised entities in preparing for changes to, or the cessation of, benchmarks. I will refer to this as the change and cessation procedure.

The clause inserts the word "robust" in paragraph 1 of article 28 to define and strengthen the nature of the change and cessation procedures that benchmark administrators are required to publish. The clause also inserts new paragraphs 1A to 1E, which set out requirements for the written change and cessation procedure that a benchmark administrator must publish.

New paragraph 1A establishes that the administrator must publish a robust written change and cessation procedure alongside the publication of the administrator's benchmark statement, which, among other things, sets out the market or economic reality that the benchmark intends to measure. The documents must be published within two weeks of the benchmark being registered in the FCA's register. Wherever a material change occurs, the benchmark administrator is required to update its written procedure. For critical benchmarks, the proposed changes in new paragraphs 1B to 1E set out additional and more stringent requirements.

When publishing its written procedure, the administrator of a critical benchmark is required to provide an assessment to the FCA, on the basis of the information available to it, that considers the nature and extent of the current use of the benchmark, the availability of suitable alternatives, and how prepared users are for changes to, or the cessation of, the benchmark. Before publishing an updated written change and cessation procedure, critical benchmark administrators must also provide that assessment together with their updated written procedure to the FCA for review. The FCA is required to review and consider whether the procedure is sufficiently robust. The administrator must not publish an update of its procedure without receiving written notice from the FCA that its procedure is sufficiently robust.

In order to be designated as a critical benchmark, a benchmark must be used extensively, and its cessation may pose significant and adverse impacts on market integrity, financial stability, consumers, the real economy, or the financing of households and businesses. It is therefore reasonable and proportionate to require administrators of critical benchmarks to demonstrate via an assessment that their cessation plans are robust. We do not expect it to be an overly burdensome assessment for benchmark administrators. The clause will support increased preparedness in the event of changes to, or the cessation of, benchmarks in the future. I therefore recommend that the clause stand part of the Bill.

Ms Eagle: Again, I have just a few questions so that I can get in my head precisely what the reason is for putting this in primary legislation. LIBOR clearly had its issues but it was used for a very long time. Is the Minister anticipating that benchmarks will change much more rapidly in the future, or does he want some kind of stability with the new benchmarks that are based on actual prices, rather than the guesses of participants in the market, as LIBOR came to be defined prior to its demise?

Is the Minister expecting that this kind of provision for ceasing benchmarks will be used regularly? I anticipate that the answer will be, "Only when it is needed because of what is happening in the market." If this kind of procedure is theoretical and on the face of a piece of legislation but hardly ever used, does that mean that the mechanisms that the Minister is setting out in clause 19 and other parts of the Bill will rust away? They will be there in theory, but there will be nobody there to work them properly. How does he anticipate that the market, the FCA and the benchmark administrators will maintain the capacity to do this if cessation is a very irregular, rare thing?

Will the Minister spend a bit of time defining what "robust" means in this context? In my time in this place, I have had many arguments with Ministers, and made many arguments as a Minister, about why we must not put particular words on the face of Bills and what their meaning is. Can the Minister enlighten us as to what he, the FCA and the Treasury mean by "robust" and how they are defining that in law, so that I can have a bit more confidence that they have got it right on the face of the Bill?

John Glen: I thank the hon. Lady for her comments. Although the provisions of this legislation are under the heading of benchmarks, they really refer to the capacity that we need to have to deal with the LIBOR issue. She is right to raise the question of the enduring provision and how tested and exercised that capacity would be, but this is about setting a framework for future use, which is very difficult to anticipate. We want to ensure that it is fit for purpose for the future.

The hon. Lady asks when the framework could be used, which is not a matter that I can reasonably be drawn on, because it would be about market conditions evolving, but it certainly means that we are ready for whatever might evolve, in terms of benchmarks on the path towards becoming critical. However, it will be for the FCA, in conversation with the market and Parliament, to determine how to bring that forward.

Ms Eagle: Does the Economic Secretary think that, given the incredible trouble that the wind-down of LIBOR has caused in the markets—not least because of what is on the face of the Bill and the very difficult issues caused by having to exit the LIBOR benchmark—it is best to try to get the next benchmark sorted and future-proofed, so that it does not turn into LIBOR 2 and cause his future successor in the Treasury and me all this kerfuffle in a Public Bill Committee?

John Glen: Absolutely. It is absolutely right that we give the power to the FCA but also keep a vigilant eye on evolving market conditions, so that we are well placed to move earlier to deal with any failures in benchmarks.

The hon. Lady asked me to define "robust" in the context of the Bill. I am reluctant to be drawn on that, because it is a matter of legal definition, but I would be very happy to write to her on that and respond at subsequent sittings of the Committee, if she wishes me to do so.

Question put and agreed to.

Clause 19 accordingly ordered to stand part of the Bill.

Clause 20

Extension of transitional period for benchmarks with non-UK administrators

Question proposed, That the clause stand part of the Bill.

John Glen: The clause amends article 51(5) of the benchmarks regulation, which provides for a transitional period during which the UK's supervised entities can continue to use all third-party benchmarks. Those are benchmarks that are provided by administrators located outside the UK. When the UK onshored the EU benchmarks regulation, the transitional period for third-country benchmarks was extended from the end of 2019 to the end of 2022. The extension was made to provide third-party benchmark administrators with more time to apply for continued access to UK markets. For the UK's supervised entities to continue to use benchmarks that are administered outside the UK after the end of 2022, the benchmarks or their administrator must be listed on the FCA benchmarks register.

The benchmarks regulation provides three access routes for third-country administrators or benchmarks. They must apply for the endorsement of specific benchmarks or for recognition as an administrator, or they can benefit from an equivalence decision made by the Treasury with respect to their home jurisdiction's regulatory framework. As of October 2020, however, only 14 third-country benchmark administrators have come through the access routes that are outlined in the EU benchmarks regulation. Industry engagement has also revealed important concerns about the operation of the current regulatory regime for third-country benchmarks under the benchmarks regulation. For example, many non-European economic area jurisdictions do not have specific regulator rules for benchmarks.

The UK will explore how best to support the use of global, non-UK benchmarks that adhere to equivalent regulatory outcomes. The endorsement and recognition access routes both rely on third-country administrators being willing to apply for market access, and require the appointment of a UK entity to facilitate their application for ongoing market access. Some third-country benchmarks are provided on a non-commercial basis, however, meaning that those administrators lack an economic incentive to apply. Smaller firms may also be reluctant to appoint a third-party UK entity to oversee their benchmark administration.

2.30 pm

Consequently, under the current regulations, UK firms are at risk of losing access to important third-country benchmarks after the end of 2022. Those benchmarks are relied on for key business functions, such as risk management, Treasury financing and overseas investment. The Government will consider changes to the third-country regime so that it is proportionate for third-country benchmarks and appropriate for the needs of the UK economy. By extending the transitional period for third-country benchmarks to the end of 2025, the clause will provide legal and economic certainty for UK firms that rely on third-country benchmarks. That will also allow the Government to fully consider and operationalise an appropriate third-country benchmarks regime for the UK. I will update the House on that in due course.

Mr McFadden: I just want to ask the Economic Secretary a question to ensure that we have properly understood the clause. All through this part of the Bill, we have talked about the different timescales in different clauses, and here we have another, which extends the transition period for benchmarks with third-country administrators until the end of 2025.

For my clarity, and perhaps for that of colleagues, will the Economic Secretary clarify whether the measures are different—I think they are—from the five and 10-year timescales in clauses 9 and 12, relating to the FCA designating what the hon. Member for Glasgow Central called zombie LIBOR? Is this five-year period about something different or does it relate to that?

Having debated this matter for a couple of hours, I am not sure that we have resolved it. My feeling is that we are leaving quite a lot to the FCA. I hope that the clause minimises the risk of harm. We have talked a lot about the risk of litigation, but there is also the risk of harm to those who have entered contracts based on LIBOR in good faith. The Government and regulators are trying to move away from that system for reasons that we understand are to minimise harm to those who signed up in good faith, but I suspect that there is still a fair bit of work for the regulator to do to ensure that that is the case.

Ms Eagle: Will the Economic Secretary share with the Committee the intention behind the extension to 2025? He said that it was to create certainty—I can understand that. Is the intention to transition to something different—the new third-country regime—after the extension, or is it to develop and introduce it earlier if it looks like there are advantages to doing so? I know that I am asking him to gaze into the future, but this will be in the Treasury and regulators' work list and they will presumably schedule it at some stage. Does he expect the creation of a third-country regime to be difficult or quite easy? Are the Government thinking of basing it on the existing regimes or diverging from what we are used to? Will he give us a little more information about how the Treasury intends to proceed with this piece of technical but very important work.

John Glen: I am very happy to address those points. The right hon. Member for Wolverhampton South East raised the issue of the different time periods. This is different from the LIBOR transition; it is about the third-party benchmarks exclusively. It is a response to the market reality, as we have seen in the number of applications. I will come to the point of the hon. Member for Wallasey in a second.

The right hon. Gentleman also asked about the risk of harm concept and how important that is. Clearly, the LIBOR transition, as we have established today, is an incredibly complicated matter with a great deal of legal complexity, an imperative to align to global best practice, the need to produce a synthetic alternative and the evolution of policy around that. It is also designed to protect. He is right to say that there is a lot more work to be done; there is no off-the-shelf solution. This measure allows the formal framework for that to evolve.

The hon. Member for Wallasey asked me to comment on the future time period by which the new third-country benchmark regime would be constructed. The extension is a response intended to resolve industry concerns and to ensure that UK markets can retain access to the third-country benchmarks. There is no intention to find some way of deviating from norms on that. It is in our interest to have complete alignment to global best practice. The extension gives UK firms the legal and economic certainty. As soon as it can be done, it should be done. I cannot give her the precise location of where that is in the work plan—the FCA has a lot on at the moment—but she is right that we need to operationalise it appropriately, recognising the different obligations on different sized firms. I will be working with the FCA to keep an eye on that in the coming weeks and months.

Question put and agreed to.

Clause 20 accordingly ordered to stand part of the Bill.

Clause 21

Benchmarks: minor and consequential amendments

Question proposed, That the clause stand part of the Bill.

John Glen: This clause inserts schedule 5, which sets out minor and consequential amendments to the benchmarks regulation to provide for the effective operation of that regulation in the context of the amendments introduced by clauses 8 to 19. I therefore recommend that the clause stand part of the Bill.

Question put and agreed to.

Clause 21 accordingly ordered to stand part of the Bill.

Schedule 5 agreed to.

Clause 22

Regulated activities and Gibraltar

Question proposed, That the clause stand part of the Bill.

John Glen: Clause 22 delivers the Government's commitment to enable Gibraltar-based firms to have continued access to the UK's financial markets. We move on, finally, from benchmarks and LIBOR; I cannot say that I am too disappointed by that.

Ms Eagle: I recognise that I missed a lot of exciting things this morning, but I do not think the Minister is really moving on from that, as he now has to do the work to put it into effect.

The Chair: It was projected that we would get up to clause 20 by the end of this morning, in fact.

John Glen: I allowed myself a moment of light-heartedness, but I can see that that was not appropriate.

In financial services, the Financial Services and Markets Act 2000 allows for several categories of authorised persons to carry on regulated activities in the UK, such as firms with domestic part 4A permission or, until the end of the transition period, EEA passporting firms. The clause provides a regime through which firms authorised for activities in Gibraltar can be recognised as authorised persons in the UK.

When significant areas of financial services regulation were set at EU level, that meant that the UK and Gibraltar followed the same rules. Now that the UK and Gibraltar have left the European Union together, the legal framework that provides for mutual market access and aligned standards needs amending. Without new permanent arrangements, Gibraltar will lose its current breadth and depth of access to the UK market, which not only would damage Gibraltar's economy and our special and historic relationship but could lead to disruption and more limited choice for UK consumers.

The detailed application of the regime is set out in two schedules, which in turn insert two new schedules into the Financial Services and Markets Act 2000: schedule 2A, as inserted by schedule 6, governing the operation of the arrangements for Gibraltar-based firms; and schedule 2B, as inserted by schedule 7, which provides for the requirements that outgoing UK-based firms must meet before accessing the Gibraltarian market.

I should clarify that we are not legislating for Gibraltar. The measure is primarily about Gibraltar-based firms' access to the UK. The Government have a responsibility to ensure financial stability and the correct operation of the UK financial services system, particularly when we open our markets to other jurisdictions. The clause therefore also requires the Treasury to lay a report before Parliament about the operation of the regime every two years.

The report will explain the Treasury's assessment of whether the three conditions in the clause—that is, compatibility with the objectives in the clause, the alignment of law and practice, and co-operation—have been met during any reporting period, and whether the Treasury therefore proposes to enable market access for particular activities. That will give Parliament confidence that regulatory and supervisory standards are being applied in a consistent manner by UK and Gibraltarian institutions, so that UK consumers can benefit from products from a wide range of providers without additional risks.

Given that clause 22 is central to the creation of permanent market access arrangements between the UK and Gibraltar, I recommend that it stand part of the Bill.

Mr McFadden: Like the Minister, I too bid a fond farewell to LIBOR. Clauses 22 and 23 and schedules 6 and 7 establish the Gibraltar authorisation regime, which could be described as a sort of mini-single market in financial services between the UK and Gibraltar. The Government have set out many detailed pages in the schedules in particular about how that mini-single market should work.

Up until now, Gibraltar has been regarded as a European territory that was a member of the EU through its status as a British overseas territory. That meant that Gibraltar had full access to single market rights, including those in financial services. Given that Gibraltar, as well as the UK, has now left the EU and is coming towards the end of the transition period, the Government clearly felt that they had to put a regime in place to be the basis of future trade in financial services between Gibraltar and the UK.

Such a regime was, to some extent, necessary, because of the volume of trade in financial services that already exists between the UK and Gibraltar. We heard during last week's oral evidence that roughly one in five car insurance policies in the UK is held by Gibraltar-based insurance companies. As I said during an oral evidence session last week, there is great good will towards Gibraltar on both sides of the House. The people of Gibraltar voted to remain in the EU by an overwhelming margin—I think it was about 95%—so we could describe the clauses and the accompanying schedules as the consolation prize to Gibraltar for having to depart the EU at the same time as the UK.

I know that under clause 22 the Treasury will report every two years on how the regime is operating. I cannot fail to reflect that that is precisely the kind of regular reporting mechanism that the Minister so stoutly rejected about four times on Tuesday when we were trying to insert it into the clauses on capital requirements. Why is it right and necessary for the Treasury to review this regime every two years but not to review the impact of change in the capital requirements on major parts of our financial system?

According to schedule 6, the report must have particular regard to paragraphs 7, 8 and 9 of that schedule, which set out the details of the new regime. Paragraph 7 tries to instil protections for the UK into this process, including for the soundness and stability of our own system, and, according to paragraph 7(c),

"to prevent the use of the UK financial system for a purpose connected with financial crime".

It goes on to talk about ensuring markets work well, the protection of consumers and, interestingly, according to paragraph 7(h), about the need

"to maintain and improve relations between the United Kingdom and other countries and territories with…significant markets for financial services."

2.45 pm

I would like to ask the Minister a few questions about the significance of the review mechanism against these criteria. Does the rolling two-year commitment mean that Gibraltar should not necessarily view these arrangements as permanent? Is the right way to think of this, rather than as the establishment of a permanent mini-single market between the UK and Gibraltar in financial services, as something akin to a renewable two-year licence to operate in the UK under this regime? Or does that overstate the importance of this two-year Treasury review mechanism?

With regard to financial crime and money laundering—we will talk about this later—has the Minister read and considered the Financial Action Task Force and Council of Europe report into "Anti-money laundering and counter-terrorist financing measures" in Gibraltar? That report, which was published about a year ago, found that while the Gibraltar Financial Services Commission and the Gibraltar Gambling Commissioner had a "robust"—that word again—

"understanding of risks at sectoral level",

there were shortcomings because of

"underestimating the cross-border threat which Gibraltar faces as an international financial centre."

It also says that

"the assessment and understanding of the FT risk are affected by insufficient consideration of data available on transactions to/from conflict zones and high-risk jurisdictions. The risk related to cross-border transportation of cash is also"

misunderstood, and goes on to say that the financing terrorism risk is "not properly understood" by the financial institutions, particularly banks and e-money providers, and that banks do not properly consider "transactions to high-risk countries". The picture painted here is of regulators trying to do the right thing and operate to UK standards, but of financial institutions operating in the territory that are sometimes not fully aware of the risks outlined in the report. What is the Minister's response?

Stella Creasy (Walthamstow) (Lab/Co-op): My right hon. Friend is making a powerful and important case about the importance of ensuring that we do not inadvertently support money laundering or standards that could enable that by accident. It is worth reflecting that in February this year, the EU anti-money laundering watchdog, MONEYVAL, called for Gibraltar to do more. One question for us in this legislation is whether there are things we can do to ensure that we are not inadvertently creating access that would enable such behaviour, now that we are leaving the European Union, which might have been offering that level of scrutiny. Does my right hon. Friend have a view on joining up those dots?

Mr McFadden: My hon. Friend is absolutely right. In fairness, I do not think that the UK system on money laundering and financial crime is perfect—we have our own issues, which we have debated before and will debate later in our consideration of the Bill—but these findings should be taken seriously, particularly as we are creating a new situation. In the past, both the UK and Gibraltar were part of the EU and we operated under the single market rules, including those on financial services. I do not know whether what we are creating is unique—I will ask the Minister about uniqueness—but it is certainly a new concept: a mini-single market in financial services between two territories.

What is the Minister's response to the report's findings? In particular, given that protection from financial crime has been written into the Bill through the Government's two-year review process, what contact has there been between the Treasury, the relevant regulators and the financial institutions in Gibraltar since the report was published a year ago? What actions do the authorities propose to take? I certainly believe that the Gibraltar authorities will want to act in good faith and try to uphold proper standards, but some of the report's findings are concerning.

Another issue raised last week was the difference in corporation tax between Gibraltar and the UK: Gibraltar's main corporation tax rate of 10% is significantly lower than our own. The Minister from Gibraltar said in his evidence, with some charm, that corporation tax would not be a factor in location—that, if anything, quality of life was more important. I have no doubt that the quality of life in Gibraltar is very good; looking out on a slightly gloomy London autumn afternoon, I have no doubt that the weather and climate is a big attraction, too. I am sure that he was right about that, but it is a big tax difference. He also pointed out—again, quite fairly—that the corporation tax differential predates our departure from the EU and has been in place for some time. However, this is a new situation, with a new, specially designed market access regime for Gibraltar being enshrined in UK law. Has the Treasury made any assessment of the likelihood of corporate relocations from the UK to Gibraltar as a result of the new measures under discussion?

I also ask the Minister about the condition, which I have described as interesting, about relationships with other territories with significant financial services markets. Why has it been written into schedule 6 as something that the Government should consider in their biennial review? Is it considered that this mini-single market will create some sort of vulnerability in those other relationships? Why is it thought possible that the arrangement might affect our relationships with other territories?

Finally, how unique and specific to the Gibraltar situation is the new regime? Could it conceivably be extended to other territories such as Jersey and the other Channel Islands? As the Minister will know, some Crown dependencies have been accused of being tax havens or of being susceptible to money laundering. Is it possible that such a regime could, in effect, be used to extend the reach of UK regulators to territories other than Gibraltar? This is a very big topic that has been debated quite a lot over recent years. I suppose I am asking about the Treasury's thinking, rather than just about the Bill: might the arrangement with Gibraltar be a model for the treatment of other Crown dependencies or overseas territories, or should we view it as specific and purely a consequence of Gibraltar having to leave the European Union? I would be grateful if the Minister considered and responded to some of those points.

Alison Thewliss (Glasgow Central) (SNP): It is a pleasure to see you in the Chair, Dr Huq. I just have a few quick questions, mainly coming from the evidence we heard last week. During the fourth sitting, at column 125, the Minister, Albert Isola, said that the Bill is akin to enabling legislation, and that other things would need to be worked through in relation to other aspects of the financial services that are currently dealt with. If the Minister could clarify what would happen about those other areas, that would be useful.

Secondly, perhaps the Minister could give further assurances about access to the Financial Ombudsman Service. It is important that consumers here should have adequate protections in the new arrangements, and that those should be made clear. That is the kind of scenario that would not be found out until a consumer needed to make a complaint. Something would have to go wrong for it to be addressed, and I would not want to be such a consumer, feeling in those circumstances that I did not have recourse to the protection that I would have had if I had chosen an insurance policy not based in Gibraltar. It would be useful to hear about that.

Lastly, it would be helpful to have any further clarity that the Minister can give about what would happen to UK businesses and customers if market access were suddenly withdrawn, and where that would leave consumers in the UK. Would they be left without policies and protection? What would happen as a reaction to that, should market access be withdrawn for a period of time? Would it mean that businesses would dry up, withdraw their UK services and go somewhere else, or does the Minister envisage other scenarios happening in that case? I appreciate that it is a scenario that he would want to avoid at all costs, but it could well arise, and I want to ask what state the Government's preparations for such a scenario are in.

Ms Eagle: I suppose I want the Minister to reassure me about the fact that financial markets are rapid and regulation—if there is an equivalence regime, or mini-single market as my right hon. Friend the Member for Wolverhampton South East put it—allows the Gibraltarian authorities to do the regulation and then have immediate access to the UK. That may be done in a way that gives us some benefit; perhaps the Minister will say what the benefits of the regime are, particularly for UK consumers, given that Gibraltar does 90% of its business with the UK anyway. Perhaps he will also say what the risks would be.

My right hon. Friend spent a little time raising some of the risks and I suppose they can be characterised by the view that in a very liquid and rapid global money market, if there are vulnerabilities or back doors into regimes that are interconnected, that causes risks. We saw some of those risks playing out during the global financial crisis. To what extent does the Minister believe that the Gibraltar regime for which the clauses legislate will be—I am going to use that word—robust enough to prevent the opening of back doors to vulnerabilities for all sorts of money that is sloshing round the world? My right hon. Friend mentioned some of that—money used for money laundering, drugs and terrorism. It is important that the defences that we have against coming under that kind of influence should be maintained and strengthened, rather than weakened.

Stella Creasy: My hon. Friend is giving the speech that I wanted to give, so I thought I would intervene. One example, to express some of the concerns we might have, is the fact that in the Gibraltar regime there is currently no legal requirement to refuse registration to someone with a criminal record. In practice that does happen. It is something that the FATF report flags, but it is not inevitable. One thing we might want to think about for our regulatory regime—and I take the point made by the shadow Minister about not suggesting that the UK regime is perfect—is looking at whether there are lessons in the report that should be put into the Bill to make sure we do not create such a back door. That seems an eminently practical example of the sorts of things that might happen if people with criminal convictions, who may still be able to access financial regulations as a result of the Gibraltar regime, are now able to operate in the UK.

3 pm

Ms Eagle: My hon. Friend gives an example of exactly the kind of point I was trying to make more generally about ensuring that these regimes are correct. Given that Gibraltar governs itself, the Bill makes it clear that Gibraltarian regulators will continue to do that job in Gibraltar and supervise the companies based there after this arrangement has been legislated for. That is quite proper in many ways, but it does give our regulators in a small number of narrowly-defined circumstances—I think this is the phrase—the duty or the right to leap in and do some regulation or enforcement presumably. Will the Minister say a bit more about that? He did mention it in passing in his introduction to the clause, in which he talked about financial stability. We clearly had some recent examples during the 2008 crash, where some robust enforcement had to take place with offshore island countries or territories that were trying to take money out of our jurisdiction in ways that were unacceptable at the time.

There is therefore a financial stability issue, but there is surely something about consumer protection, fraud and money laundering here as well. Perhaps he could talk in more detail about what those narrow circumstances are. Our regulators will be reluctant to romp and stomp all over Gibraltarian institutions and their regulators. Yet, by definition, Gibraltar is a small territory, and it will have less capacity to deal with some of the sophisticated fraudsters and international terrorist, money-laundering types than we do here. I am not saying that our regime is perfect, if we are honest, and we will get on to that later in the Bill.

My worry is that this might inadvertently create some vulnerabilities. I suppose what I am seeking from the Minister is some reassurance that the regulators have got a handle on this, that they will not allow the wish not to infantilise the Gibraltarian regulators to be a reason for not paying close attention to this, and that there will be some close supervision of what is happening, particularly once the regime is established. Once these things settle down, it is then that things start to happen. If a door is opened inadvertently somewhere, this money swilling around tends to find it, and then things can start changing very rapidly.

What warning flags does this regime put up to ensure that if that dynamic begins to happen, we can close it down rapidly? Does the Bill expect some kind of relationship between the Gibraltarian regulators and the Treasury? How does the Minister expect that relationship to work out? Obviously, I do not want to spend all my time being so negative about these things, so will the Minister also say a little more about what the benefits might be?

Will the Minister also talk about consumer protection in his response? Motor insurance is one of the largest components of the financial services that Gibraltar currently sells into the UK, and clearly there is a big retail consumer protection angle to such financial services.

Stella Creasy: While we are considering the variations for companies based in Gibraltar as opposed to the UK, it would be helpful if the Minister answered the question that the insurance bodies could not: about VAT benefits for companies based in Gibraltar and the likelihood, now that we have left the European Union, of companies moving more industry to Gibraltar because of that benefit, which could also affect consumers. Does my hon. Friend agree that it would be helpful if the Minister set out those figures? The industry seemed slightly coy when we spoke to it about those matters.

Ms Eagle: Clearly, the potential situation is there now. In evidence, the response—reasonably—was that that has not happened to date, even though there have been close connections between Gibraltar and the UK. However, these things tend to be dynamic and, once the

[Ms Angela Eagle]

agreement with Gibraltar is established, our tax regimes may diverge even further. If the Chancellor has his way after yesterday's statement, I suspect they might have to.

Will that create more of a temptation for financial service companies to offshore to Gibraltar outside of the UK? Is the Minister convinced that that will not happen as a result of the Bill? I want reassurance from him about those potential weaknesses or risks and about consumer protections. He might even want to say a bit about benefits, if he feels up to it.

John Glen: I counted several questions in those four contributions and I will do my best to address them. First, I will reiterate what we are trying to do: to create the market access regime for Gibraltar-based financial services wishing to operate in the UK, and to make provision for outbound UK-based firms wishing to operate in Gibraltar.

The right hon. Member for Wolverhampton South East made a number of points, which I will start to address. He asked about the two-year reporting mechanism. The Gibraltar authorisation regime provides a broader and deeper market access into the UK market—including to the retail market—than other market access regimes, so the Treasury needs to be satisfied continuously that all conditions are met. We will therefore work carefully with the Minister we spoke to last week from the Government of Gibraltar to ensure that those conditions can be satisfied on an ongoing basis.

It is important to contextualise the nature of the relationship with Gibraltar. There has been a lot of dialogue, visits—not latterly—and evaluation of each other's situation with respect to market access. In the lead up to the new regime, the Treasury will assess Gibraltar against the relevant market conditions for the sub-sectors to which it seeks access, and we will work closely with the Government of Gibraltar. The most significant area is the Gibraltarian insurance market, and 90% of that is UK facing.

The right hon. Gentleman compared the two-year review to our refusal to review the prudential regimes. As we have already discussed, the prudential measures include an accountability framework; we had a different view on the suitability of the one we suggested versus the amendment. The regulators have the expertise to set rules in the complex and technical areas of financial regulation and can do so in an agile way.

The right hon. Gentleman also referred to the FATF report. I have not read it in full, but I am aware of its broad indications of the challenges that exist. I am also aware that, while we had a good report, there are some challenges that we need to address in the UK. I will not hold back on admitting that. I will write to him specifically on those measures that pertain to Gibraltar, because I ought to do justice to his proper scrutiny.

There is an issue with the extension of the Gibraltarian regime to other countries. That is a bespoke regime that has been specifically designed for Gibraltar, recognising what the right hon. Gentleman and others will acknowledge is a special historical relationship, and our past common membership of the EU. These circumstances do not apply to any other jurisdictions, so that is not designed as a model or, as he said, a mini-single market to be extended elsewhere.

The hon. Member for Glasgow Central asked about the scope of the FOS jurisdiction over products sold by Gibraltarian firms. Our intention is that all Gibraltar-based firms with a schedule 2A commission will be covered by the FOS's compulsory jurisdiction. That ensures that individuals and small businesses can seek appropriate redress. However, the extension of the FOS's jurisdiction to schedule 2A firms does not require express wording in this Bill. The Bill makes schedule 2A firms a type of authorised person, so the FCA be able to make rules about them, bringing them inside the FOS's remit. The FCA will be reflecting that change in the rules governing the FOS's jurisdiction. Firms already under the FOS's voluntary jurisdiction will transfer to the compulsory jurisdiction, with no loss of eligibility for their consumers in respect of actions occurring before they entered the compulsory jurisdiction.

The hon. Member for Glasgow Central also asked about the withdrawal of equivalence. If market access were to be withdrawn, schedule 2A puts in place winding down arrangements that enable the Government to pass secondary legislation providing for Gibraltar-based firms to exit the market in an orderly fashion, with appropriate protections for UK consumers. That is what would happen in market failure.

Stella Creasy: The Minister was just talking about the Financial Ombudsman Service being extended. One of the things that we might be concerned about is that our constituents might experience fraud from companies based in Gibraltar, perhaps in relation to insurance. Many of us can think of some famous Brexit backers who run insurance companies in Gibraltar and might have concerns about these issues. The FAFT report tells us that at the moment the supervision is only for new companies. There is a historical legacy of companies that have not previously been registered that might, therefore, under new supervision, be companies that we would not want to see operating in the UK. The Minister talked about the FOS's requirements being retrospective, but that will be the same with the FCA. Can he clarify that if there are companies that are historically registered in Gibraltar, which we would not want to see registered here, perhaps because the people running them have criminal records, will they retrospectively be denied a licence, or is it only those from new registrations onwards, as with the current Gibraltarian regime?

John Glen: I wish to examine that matter carefully on the basis of the FATF report. I totally understand the clear point the hon. Lady is making about the retrospective nature of this and what could we essentially onshore, in terms of access to UK consumers, and the inherent and apparent risks in that. If the hon. Lady will permit me, I would like to examine that and get back to her.

The hon. Member for Wallasey asked about the independent Gibraltarian regulator and whether it will remain the supervisor of Gibraltar-based firms. The explicit intention for the UK regulators, contained in proposed schedule 2A, is to guarantee the protection of UK consumers, but that will be exercisable only on specific grounds, for example where a situation is urgent or if a Gibraltar-based firm is contravening a rule. We are not trying to take over their regulator.

The hon. Lady asked if the parties will co-operate sufficiently. There has been close and frequent co-operation over the past three years, between both Governments and regulators. They are developing their regime, and I am confident that will continue. The Minister in Gibraltar—effectively, my opposite number there—was positive about that last week. Schedule 2A will create a framework for this effective co-operation. That also means that the UK and Gibraltar Governments, the respective regulators and the Financial Services Compensation Scheme will put in place effective procedures to carry out any dialogue and co-ordinated action for the good functioning of the regime.

The hon. Members for Walthamstow and for Wallasey asked about consumer protection. It is obviously of the upmost importance that we provide the right level of protection for UK customers of Gibraltarian products, and that the level of protection afforded is communicated to them. Under this regime, most UK-based consumers purchasing products from Gibraltarian providers will receive a similar level of compensation as those purchasing their products from UK firms, whether through the FSCS or through the equivalent Gibraltarian schemes.

3.15 pm

Schedule 8 will amend the Financial Services and Markets Act in relation to the FSCS to adapt the provisions to the new framework, and I can confirm that, under the GAR, UK consumers of Gibraltarian products will receive a similarly high level of compensation as consumers of UK-based firms, either through the FSCS or through the equivalent Gibraltarian scheme.

The other point that was made on Second Reading, and possibly in some of the questions last week—the right hon. Member for Wolverhampton South East referred to it—was the risk of relocation, notwithstanding the different climates. While we were members of the EU together, financial services firms were already able to base themselves in Gibraltar and access the UK market. Reflecting on what the witnesses said last week, a wide range of issues will have played a role in firms choosing Gibraltar as a base, including the availability of specialised personnel. Given the geography of the Rock, obviously there are some constraints there.

The hon. Member for Wallasey referenced the differential tax regimes, but there is a wide range of factors that would clearly provide some meaningful checks on rapid movement over there to access that regime. There are also significant costs involved in relocating to another jurisdiction. Obviously, Gibraltar is fiscally autonomous; it has its own democratically elected Government, who will continue to set the rates of taxation. The interaction between ourselves is a matter of speculation. I do not think that I can say much else on that point. I hope that has given some satisfaction to Opposition colleagues.

Question put and agreed to.

Clause 22 accordingly ordered to stand part of the Bill.

Schedule 6

Gibraltar-based persons carrying on activities in the UK

John Glen: I beg to move amendment 4, in schedule 6, page 100, line 31, at end insert—

“(i) an order under section 143S, or”.

This amendment extends the definition of “prohibition order” in paragraph 19 of new Schedule 2A to the Financial Services and Markets Act 2000 to include an order under section 143S (inserted by Part 1 of Schedule 2 to the Bill).

The Chair: With this it will be convenient to discuss Government amendments 5 to 11.

John Glen: These very simple and limited amendments are necessary to ensure that the measure functions as intended. As the explanatory note states, amendment 4 expands the definition of “prohibition order” in paragraph 19 of new schedule 2A to the Financial Services and Markets Act 2000 to include an order made under section 143S, as inserted by part 1 of schedule 2 to the Bill.

The amendment ensures that UK regulators can reject a notification in relation to a Gibraltar-based firm if a senior manager of the Gibraltar-based firm is prohibited from performing a function by a part 9C prohibition order made under new section 143S, in line with the treatment of other firms in the Bill. A part 9C prohibition order may be made by the FCA in relation to an individual if the FCA believes that the individual is not of sufficiently good repute or does not possess sufficient knowledge, skills and experience to perform a function relating to an activity carried on by a non-authorised parent undertaking of an FCA investment firm.

Amendment 5 expands the definition of “prohibition order” in paragraph 19 of new schedule 2A to the Financial Services and Markets Act 2000 to include an order under the law of Gibraltar that the appropriate UK regulator considers to be equivalent to an order under section 143S as inserted by part 1 of schedule 2 to the Bill. That is a simple and limited expansion enabling the UK regulators to reject a notification if a senior manager of a Gibraltar-based firm is prohibited from performing a function by a prohibition order under the law of Gibraltar that they consider to be equivalent to an order under section 143S.

Finally, amendments 6 to 11 clarify the UK regulators’ powers to give directions altering the meaning of “protected contract” and “existing contract” for the purposes of part 10 of new schedule 2A to the Financial Services and Markets Act 2000 in the event that a UK regulator or the Gibraltar regulator cancels the permission of a Gibraltar-based firm.

Amendment 4 agreed to.

Amendments made: 5, in schedule 6, page 100, line 34, after “56” insert “or 143S”.

This amendment extends the definition of “prohibition order” in paragraph 19 of new Schedule 2A to the Financial Services and Markets Act 2000 to include an order under the law of Gibraltar which a UK regulator considers to be equivalent to an order under section 143S (inserted by Part 1 of Schedule 2 to the Bill).

Amendment 6, in schedule 6, page 123, line 32, leave out “67” and insert “67(1)”.

See the explanatory statement for Amendment 11.

Amendment 7, in schedule 6, page 123, line 38, leave out “67” and insert “67(2)”.

See the explanatory statement for Amendment 11.

Amendment 8, in schedule 6, page 124, line 37, leave out “67” and insert “67(1)”.

See the explanatory statement for Amendment 11.

Amendment 9, in schedule 6, page 124, line 43, leave out “67” and insert “67(2)”.

See the explanatory statement for Amendment 11.

Amendment 10, in schedule 6, page 125, line 17, leave out

“this Part of this Schedule”

[John Glen]

and insert

"paragraph 64 or 65 (or both)".

See the explanatory statement for Amendment 11.

Amendment 11, in schedule 6, page 125, line 19, leave out

"The power under sub-paragraph (1) includes power to"

and insert

"A UK regulator may, by giving a direction,".—*(John Glen.)*

This amendment and Amendments 6, 7, 8, 9 and 10 clarify the UK regulators' powers to give directions altering the meaning of "protected contract" and "existing contract" for the purposes of Part 10 of new Schedule 2A to the Financial Services and Markets Act 2000.

Question proposed, That the schedule, as amended, be the Sixth schedule to the Bill.

John Glen: New schedule 2A to the Financial Services and Markets Act 2000 sets out in detail the operation of the new market access arrangements for Gibraltar-based firms into the UK. Part 1 of the schedule defines key concepts of the new framework, such as approved activity. Part 2 sets out that the Treasury will be able to designate a regulated activity as an approved activity for market access only if the following conditions are met: if approval of an activity is compatible with certain objectives, such as financial stability and consumer protection; if the Treasury is satisfied that the relevant law and practice between the UK and Gibraltar is sufficiently aligned; and if the Treasury is satisfied that there is co-operation between the UK and Gibraltar Governments, our respective independent regulators and the FSCS.

Part 3 will introduce a simple notification process by which Gibraltar-based firms will be able to obtain permission to carry on an approved activity. I stress that this is not intended to be an application process; Gibraltar-based firms will automatically obtain a schedule 2A permission once the period for the UK regulators to consider a notification has expired. Parts 4 to 6 provide for the Gibraltarian regulator or the UK regulator to be able to vary or cancel a schedule 2A permission, or to impose, vary or cancel requirements on a Gibraltar-based firm, and set out the process the regulators could follow in each case. None of those powers dilutes the fact that Gibraltar-based firms will continue to be supervised by the Gibraltarian regulator and remain subject to the laws of Gibraltar. The intervention powers for the UK regulators will be available only in specific defined circumstances, as set out in paragraph 28. The option of withdrawal of approval for an activity will remain available to the Government as a tool of last resort. However, were any issues to emerge, the Treasury would work closely with the Gibraltarian authorities to ensure that all conditions of market access can be satisfied.

To provide clarity and transparency, part 11 will require each UK regulator to issue a statement of its policy on the use of its intervention powers. Part 12 imposes duties on the UK regulators to inform, consult and obtain consent from one another, as well as to keep the Gibraltarian regulator informed to support the functioning of the regime. Similarly, part 13 will require co-operation between the UK and Gibraltar Governments, our independent regulators and the manager of the FSCS, including setting out procedures and approaches to resolving any supervisory concerns to support the delivery of the regime.

I have summarised the effects of proposed new schedule 2A in the legislation. It sets out in great detail the new market access arrangements for Gibraltar-based firms looking to operate in the UK and it will lead to the renewal and strengthening of our relationship with Gibraltar. For that reason, I therefore recommend that the schedule be agreed to.

Question put and agreed to.

Schedule 6, as amended, accordingly agreed to.

Schedule 7 agreed to.

Schedule 8 agreed to.

Clause 23

Power to make provision about Gibraltar

Question proposed, That the clause stand part of the Bill.

John Glen: The new regime introduced by clause 22 revolves around activities covered by the so-called Gibraltar order, which provides Gibraltar-based firms accessing UK markets and UK-based firms accessing Gibraltar markets with rights equivalent to the passporting rights conferred on European economic area firms. Certain regimes conferring rights on UK and Gibraltar firms sit outside the remit of the Gibraltar order, as they are authorised not under the Financial Services and Markets Act but under separate regulatory regimes, and therefore need to be addressed separately.

The majority of these regimes are not as central to the UK-Gibraltar bilateral relationship as the regimes under clause 22, as they represent smaller sub-sectors such as e-money and payment services. The Government are requesting a delegated power to make provision for these regimes, which will allow the Treasury to safeguard the rights that Gibraltar firms currently exercise, to ensure that the legislative framework works efficiently and, wherever possible, to subject these regimes to principles and mechanisms similar to those in the new section 32A of and schedules 2A and 2B to the Financial Services and Markets Act, to ensure consistency with the rest of the regime introduced by clause 22.

Regarding the regime introduced by clause 22, it is right and proportionate that the Government are able to make adjustments to take account of the UK's and Gibraltar's new position outside the European Union and in relation to the regimes not captured by the Gibraltar order. The power that the Treasury is requesting is not unlimited, but is constrained at multiple levels. The power is limited in scope, as it only applies to a narrow pool of legislative regimes, as described in clause 23, which are not covered by clause 22. Further, this power can be exercised only in a manner that is compatible with the objectives set out in clause 23, such as financial stability and consumer protection. In addition, the Treasury must consult the FCA, the PRA and the Government of Gibraltar before making certain regulations. Finally, all regulations made in the exercise of this power will be subject to the affirmative procedure, giving Parliament effective oversight of the exercise of these powers by the Treasury.

The clause is crucial to ensuring a consistent approach to regulatory supervision, co-operation and other relevant standards and requirements across different financial services regimes. It achieves the right balance between accountability and effectiveness, so I recommend that the clause stand part of the Bill.

Ms Eagle: Given that some of the areas caught by this part of the regulation were previously quite esoteric, but might not be so esoteric in the not-too-distant future—I am thinking of electronic money, which a few years ago would have been a tiny amount of transactions and is now very much larger—can the Minister reassure the Committee that, if the size and importance of these transactions grow, they are confined in the right area of the law for regulation? Does the Treasury have any views on how to take account of the changing importance and size of this area and to change the regulations around it in future? As we see, the pandemic has meant that many people who used to use cash no longer use it. Payment services and e-money are growing areas and could grow rapidly.. Is he convinced that this is the right regime to have in and around areas of perhaps rapid evolution?

3.30 pm

John Glen: I thank the hon. Lady for that relevant question about how we intend to apply these powers to smaller regimes that are of increasing significance to consumers and potentially to stability. As a Government, our intention is to ensure that existing cross-border activities are not disrupted in any way. We are asking for the ability to update these regimes to reflect the growing relationship and the evolving domestic mechanisms and principles.

To some extent, many of these areas being looked at now—crypto-assets, stablecoins and so on—are evolving globally and there is is a spectrum of approaches, so we need to examine the appropriateness of the application. We would work to examine closely where the risks are, and therefore where the application of new and evolving orthodoxies of regulation would apply to Gibraltar. We are committing to ensuring that the necessary legislative arrangements are in place in any event, but we rule nothing out in terms of scope and application to new sectors as the world of financial services evolves, which it has done considerably in recent years.

Question put and agreed to.

Clause 23 accordingly ordered to stand part of the Bill.

Clause 24

COLLECTIVE INVESTMENT SCHEMES AUTHORISED IN APPROVED COUNTRIES

Question proposed, That the clause stand part of the Bill.

John Glen: The clause introduces the new overseas funds regime, which delivers on the Government's commitment to introduce a simpler way for large numbers of investment funds from other countries to be marketed to retail investors, including the general public. The OFR will promote openness to overseas markets, allowing the UK to offer broad market access to investment funds from other countries. It will also allow consumers to benefit from the widest possible choice of funds, while maintaining existing levels of investor protection.

The new regime could provide a more efficient way of allowing large numbers of investment funds from the EEA to market to retail investors on a more permanent basis. Many EEA funds are marketed into the UK through the EU's passporting regime, which will end after the transition period. Although the Government have introduced a temporary marketing permissions regime to allow existing EEA funds to continue marketing after the transition period, these funds will need to apply for permission to market on a more permanent basis. If the OFR were not legislated for, the funds would have to apply for recognition under the existing regime; that regime allows overseas funds to be marketed to the general public, but it requires an assessment of each individual fund. Establishing the OFR could therefore provide a more permanent basis for these EEA funds to continue marketing in the UK, provided that the EEA member states are found equivalent. It will also allow for the possibility of funds in other countries gaining easier access to the UK if they meet the criteria set out in the schedule. The new regime has been welcomed by the UK's asset management industry, and the majority of consultation respondents were highly supportive.

I will now detail how clause 24 introduces the new OFR. The clause adds to the legal definition of a recognised scheme, so that it includes funds recognised under the OFR. That will allow the funds to market to the general public in the UK. The clause also introduces schedule 9 to the Bill, which comprises the main operational elements of the OFR and any minor and consequential amendments needed to ensure the new regime is fully functional. Compared with the current assessment of individual funds, the OFR enables the Treasury to make equivalence determinations which allow specified categories of funds from other countries and territories to be marketed in the UK. Therefore, the OFR has the potential to promote the interconnectedness of financial markets and consumer choice, to provide a more appropriate basis for recognising the large number of EEA funds currently marketing through the temporary marketing permissions regime, and to support bilateral agreements with other countries.

The clause is necessary to ensure that the OFR is inserted into the relevant legislation and can fulfil its potential. I recommend that it stand part of the Bill.

Mr McFadden: I thank the Minister for his explanation. As he said, this clause, schedule 9 and clause 25 create an overseas fund regime for establishing the recognition of collective investment schemes based outside the UK. It is estimated that there are about 9,000 such schemes, which are often known as UCITS.

Up until now, those schemes have operated under the European Union's passporting provisions, as have UK-based schemes operating in other countries; it has been a two-way street. It was not inevitable that passporting had to end when the UK left the EU. There were models of leaving that could have preserved those rights for UK-based firms. Indeed, there were votes in Parliament that sought to guarantee the continuation of passporting rights, but the Government set their face against that, so the first thing to say about these provisions is that the need for them has arisen out of choices made by the Government.

That there would be an adverse impact on services from this decision was acknowledged. It seems the dim and distant past now, but back in the halcyon days of 2018, we had something called the Chequers plan. That document was issued in July 2018 with—I noted when I had another look at it—a foreword from the current Foreign Secretary. The Minister could usefully remind him of that the next time he bumps into him. The document said that the Government

"acknowledges that there will be more barriers to the UK's access to the EU market than is the case today."

[Mr McFadden]

It went on to note that

"these arrangements will not replicate the EU's passporting regimes".

Let us look at what the document's verdict was on equivalence, which is the thing that we are trying to achieve and in part legislate for today. This is the Government's own verdict on the kind of regime in clauses 24 and 25 and schedule 9. It said:

"The EU has third country equivalence regimes which provide limited access for some of its third country partners to some areas of EU financial services markets. These regimes are not sufficient to deal with a third country whose financial markets are as deeply interconnected with the EU's as those of the UK are. In particular, the existing regimes do not provide for:…institutional dialogue…a mediated solution where equivalence is threatened by a divergence of rules"—

we have discussed divergence of rules quite a lot in this Committee—

"or supervisory practices…sufficient tools for reciprocal supervisory cooperation…This would lead to unnecessary fragmentation of markets and increased costs to consumers and businesses; or…phased adjustments and careful management of the impacts of change, so that businesses face a predictable environment."

That is not my verdict on equivalence; it is the Government's verdict on equivalence when they published their own plan two years ago. So there we have it in the Government's own words. That which they have been as yet unable to secure from the EU was dismissed as inadequate for the UK's financial services sector even if we were able to secure it, which we have not, or at least not yet. The Government were aiming for something different, because it was deemed by them to be inadequate. They were aiming for

"a bilateral framework of treaty-based commitments to…ensure transparency and stability",

because, as the document goes on to say, equivalence

"is not sufficient in scope for the breadth of the interconnectedness of UK-EU financial services provision. A new arrangement would need to encompass a broader range of cross-border activities".

The Government wanted common principles, supervisory co-operation and

"a shared intention to avoid adopting regulations that produce divergent outcomes".

Where did all that go? What happened to all of that? That was the aim. Why is it now the summit of the Government's ambitions to achieve an outcome for the UK's globally significant financial services sector that they dismissed as inadequate only two years ago? Why is this not at the heart of the UK-EU negotiations, in this crucial period? We have just over a month left—less, in real terms—to strike a deal. We must think of the significance of this sector to the UK economy and look at the employment, the investment and the tax revenue.

Stella Creasy: The shadow Minister is making a powerful case, and I suspect he is about to move on to this point. In layman's terms, the Government are asking financial companies, which represent hundreds of thousands of jobs in our country, to deal with more paperwork, more bureaucracy, more regulation and a tougher business environment in which to operate. Does the shadow Minister think that these major financial companies are going to adhere to that because they are rather fond of London, or might they make different commercial decisions because we have not secured the kind of regulation he is talking about as yet and move themselves to other parts of the European Union?

Mr McFadden: We will come on to their reaction. It is extraordinary that a sector this important has been relegated so far in the Government's priorities. It is absolutely extraordinary that in these final days of renegotiation this is not front and centre. We just need to look at the employment, the investment and the tax revenues, and the role that the sector can play in global standards. Yet it has been relegated by the Government to an outcome that they admit is inferior and which, right now, they have not even been able to achieve.

All we can legislate for here is what we do. The fact that it is not front and centre of the negotiations right now speaks volumes about how far we have drifted from talk of achieving all the same benefits and securing a free trade zone from Iceland to the Urals—do hon. Members remember that? All of that has gone.

Ms Eagle: Is my right hon. Friend therefore surprised or unsurprised that the Office for Budget Responsibility documents yesterday said that the cost of the end of the transition period will be an economy that is permanently 2% smaller?

Mr McFadden: That is the OBR's estimate of the additional cost of a no-deal scenario, on top of the already long-term hit in the deal scenario. My hon. Friend is absolutely right to set that out.

The fact that this has happened slowly over the past couple of years, and maybe the fact that the industry has become weary of arguing about it—as, perhaps, have all of us—should not disguise the importance of what has happened. It is important to set that out and to put these clauses in perspective. The Government chose to relegate the importance of UK financial services industries in the Brexit negotiations. Having made that decision, they then relegated financial services even further by aiming for an outcome that they openly admitted was inadequate, and they have not even been able to achieve that outcome. That is the context of these clauses.

I have a few questions on the details of the regime being established by the clauses. First, how does this relate to the Chancellor's statement on financial services on 9 November? The clause and schedule 9 set out a country-by-country approval system for equivalence decisions, but in his statement on 9 November the Chancellor said that he was publishing a set of equivalence decisions for the UK and the EEA member states—those member states who still have access to these passporting rights, even though they are not EU members. Clause 24, as I said, implies a country-by-country process. Does the Chancellor's statement mean that in policy terms, the equivalent recognition has already been given to all EU and EEA member states? Is that for all the financial products that are produced to which such equivalence might apply—that is, those traded on a cross-border basis?

3.45 pm

Secondly, the regime being established here still requires company and product registration with the FCA, as I understand it. Is this process of registration necessary for the 9,000 collective investment products from EU member states that already exist, or is it only for new products for firms based in those states? I know that the intention is to make this a fairly light administrative burden for the firms and the regulators. Can the Minister tell us a bit more about how that firm-by-firm registration process would work?

Thirdly, can the Minister confirm what the scope of these provisions is geographically? I appreciate that this regime is being established with EU countries in mind, but is it applicable to countries outside the EU, which may wish to sell investment products here, for example from the United States or elsewhere?

Fourthly, could the Minister say something about the permanence or otherwise of the equivalence status being granted? In what circumstances could the Treasury and the regulators withdraw that equivalence recognition? Given that this is a country-by-country system, would withdrawal operate at the level of a country or the individual firm, or could it operate on the basis of both the country and the individual firm?

My fifth question relates to the products themselves. Given that as things stand we are granting equivalence recognition to firms from EU countries, but we have not secured equivalent recognition for companies from this country, does this mean that there will be two types of uses marketed in the UK—one EU type and one British type—and will there be differences between those two products, given that one has Europe-wide recognition and the other does not?

Finally, could the Minister give us an update on when he expects to hear about reciprocal decisions in response to the Chancellor's announcement of 9 November? I know the Minister is hoping for a positive response, and I am too. It is very much in the interest of the financial services sector to get this recognition, even though it is much less than we were aiming for at the beginning of the process. What is the relationship between the desire for equivalence and all the powers of divergence that we put into the Bill? Is it not the case that there is a risk that the EU will watch to see how we use all these divergence powers on one directive after another before deciding about granting equivalence to UK firms?

In conclusion, I can understand why the Government are legislating for this regime. They want to minimise market disruption here in the UK. I can understand how doing it in this way makes things more manageable for our regulators, but no one should be in any doubt that this does not come anywhere near what it was claimed would be achieved for financial services at the start of this process. The fact that all of us are hoping for a positive response from the EU does not illustrate us taking back control; it is a graphic and, potentially, economically significant example of control being lost.

Alison Thewliss: I have one or two further questions about people who are invested in things for which equivalence is withdrawn. The Association of British Insurers said in its written evidence:

> "While the regime states that investors can stay invested in funds if equivalence has been withdrawn, they do not to spell out the practicalities of the situation an existing investor may face if a fund they are invested in has been suspended, for example if additional money is invested after a fund suspension. For the regime to fully work for consumers, situations such as this need to be clarified."

What happens to investors in those funds if equivalence is withdrawn? What information will they receive from the Government, from regulators or from anybody else if that happens, so that they know what they have to do in that scenario, if anything? That could affect many people and would be very complicated to unravel, so it would be useful to set out people's obligations in those circumstances.

John Glen: We were treated to more of a Second Reading response there from the shadow Minister, with all that he said about the frustrations of the last three years. Having been Minister for three years under three Chancellors and seen the evolution in the nature of that negotiation, I have a lot of empathy with his analysis about the evolving nature of a negotiation, which is of course what happens.

I can tell the right hon. Gentleman that the whole issue of the importance of financial services has gripped me since 9 January 2018, when I came into the role, and he is absolutely right to say that it is a very important industry and that we must do all that we can to maximise opportunities for it. I very much regret where we are on what we thought would be a technical process of equivalence granting. We filled in 2,500 pages of forms over about 40 questionnaires by June last year and, self-evidently, we have been leaders in the regulation of financial services within the EU. We have not heard anything from the EU on the equivalence determinations, which is strange. We regard the EU as some of our most important trading partners, and we look forward to continuing a constructive dialogue.

The right hon. Gentleman raised a number of questions about the Chancellor's statement, the registration process and the situation for jurisdictions beyond the EU, and I will address those. On the equivalence for UK firms, although the EU does not currently have an equivalence regime for the marketing of investment funds—we cannot speak for any future changes to the EU's equivalence framework—the Government are introducing the new equivalence regime for overseas investment funds to market to UK retail investors, to allow our consumers to benefit from the widest possible choice of funds. We are doing that to support and preserve consumer choice for UK investors. Currently, about 9,000 EEA-domiciled funds use passporting to market to retail investors in the UK. That makes up a substantial proportion of the overseas funds that are on offer to UK investors. In comparison, about 2,600 UK-domiciled funds are available to UK investors, and UK funds do not commonly sell into the EU.

The geographic scope of the OFR could be used to find any jurisdiction equivalent, but a fund from another jurisdiction could be permissible even if the jurisdiction is not equivalent. That would use a different process—the existing process, which I think is provided for in section 272 of the Financial Services and Markets Act 2000. We hope and expect to refine that to align it with this process to remove any uncertainty.

The Chancellor's announcement of 9 November, when we made 17 equivalence decisions, is separate to the OFR, which is a new equivalence regime that the UK is introducing for EEA funds. The withdrawal of equivalence can happen at the country level, but the FCA has powers to suspend or revoke the marketing permissions of individual funds. If funds from a country are found equivalent under the OFR, they will not need to go through the section 272 provision, so this will be a faster route.

The hon. Member for Glasgow Central asked what happens to investors if equivalence is withdrawn or a fund is suspended. Obviously equivalence is necessary

[John Glen]

to ensure that UK investors can assume at least equivalent investor protection to that of the UK. If the Government believe that that is no longer the case, it would be appropriate for the Treasury to act and to make that clear to potential existing investors by withdrawing equivalence.

We recognise the importance of clarity and stability regarding the potential withdrawal of equivalence, so withdrawing an equivalence determination will be undertaken in an orderly and controlled manner to ensure that investors are protected and businesses have time to adjust. In the event of equivalence being withdrawn, funds from the country or territory in question will no longer have recognised status and can no longer be marketed to the general public in the UK.

The Treasury does not envisage that investors will be forced to divest their investments in the fund, and the funds should continue to service them; however, the loss of recognition could make it more difficult for investors to continue investing in the fund.

For example, the loss of recognition might result in investment platforms no longer offering the fund on their platforms. The Bill also includes a power so that the Treasury can take steps to smooth the transition for funds to the existing regime if equivalence has been withdrawn.

Alison Thewliss: I thank the Minister for that clarification. I am just trying to get my head around the practicality or how this would work. If equivalence is withdrawn, how do people who have money in the funds find out about it? Is there an obligation on the funds to tell them, or on the Government to ask the funds to tell them? Do the Government somehow contact these people, and what is the timeline of those things, should that occur?

John Glen: That procedure would depend on the particular breakdown of the fund and the scale of the problem. It would be for the regulator to work with the individual fund to demonstrate that, and to give clarity to consumers. It is difficult without a specific example to set that out, but the provision is there and the provisions are comprehensive in terms of being able to do that.

The right hon. Member for Wolverhampton South East asked about the relationship between equivalence and the divergence allowed for by the Bill. The Bill makes no assumptions about what the relationship between the UK and the EU will be in the area of financial services. That negotiation is ongoing. That is entirely consistent with the mutual findings of equivalence. It ensures that the right framework is in place for making equivalence decisions and for ensuring that any likely impact on existing equivalence decisions is taken into account when making rules in an area covered by the Bill.

I have tried to cover everything that has been raised. I am sure that I have not covered everything, but if I find anything substantive when I reflect on today's proceedings, I will write to the right hon. Gentleman and make the letter available to the Committee.

The Chair: These letters are coming back quite quickly. The one from the other day is already here, so we look forward to any future ones.

Question put and agreed to.

Clause 24 accordingly ordered to stand part of the Bill.

Schedule 9

COLLECTIVE INVESTMENT SCHEMES AUTHORISED IN APPROVED COUNTRIES

Amendments made: 12, in schedule 9, page 151, line 16, leave out

"granting an application under section 271A"

and insert

"under section 271A granting an application under that section".

This amendment clarifies that both the application and the order are made under section 271A.

Amendment 13, in schedule 9, page 154, line 43, leave out "271G" and insert "271A".

This amendment and Amendments 14, 15, 16 and 17 correct cross-references to the section under which an order recognising a scheme is made.

Amendment 14, in schedule 9, page 155, line 14, leave out "271G" and insert "271A".

See the explanatory statement for Amendment 13.

Amendment 15, in schedule 9, page 155, line 24, leave out "271G" and insert "271A".

See the explanatory statement for Amendment 13.

Amendment 16, in schedule 9, page 156, line 7, leave out "271G" and insert "271A".

See the explanatory statement for Amendment 13.

Amendment 17, in schedule 9, page 156, line 29, leave out "271G" and insert "271A".—*(John Glen.)*

See the explanatory statement for Amendment 13.

Schedule 9, as amended, agreed to.

Ordered, That further consideration be now adjourned.—*(David Rutley.)*

4 pm

Adjourned till Tuesday 1 December at twenty-five minutes past Nine o'clock.