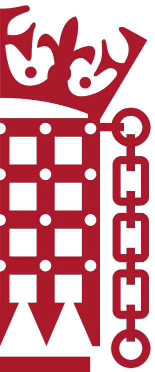

HOUSE OF LORDS

Secondary Legislation Scrutiny Committee (Sub-Committee B)

1st Report of Session 2017–19

Proposed Negative Statutory Instruments under the European Union (Withdrawal) Act 2018

Draft EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018

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Secondary Legislation Scrutiny Committee (Sub-Committee B)

The Committee's terms of reference, as amended on 11 July 2018, are set out on the website but are, broadly:

To report on draft instruments and memoranda laid before Parliament under sections 8, 9 and 23(1) of the European Withdrawal Act 2018.

And, to scrutinise –

(a) every instrument (whether or not a statutory instrument), or draft of an instrument, which is laid before each House of Parliament and upon which proceedings may be, or might have been, taken in either House of Parliament under an Act of Parliament;

(b) every proposal which is in the form of a draft of such an instrument and is laid before each House of Parliament under an Act of Parliament,

with a view to determining whether or not the special attention of the House should be drawn to it on any of the grounds specified in the terms of reference.

The Committee may also consider such other general matters relating to the effective scrutiny of secondary legislation as the Committee considers appropriate, except matters within the orders of reference of the Joint Committee on Statutory Instruments.

Members

Rt Hon. Lord Cunningham of Felling (Chairman)
Baroness Donaghy
Lord Goddard of Stockport
Lord Hodgson of Astley Abbotts
Rt Hon. Lord Janvrin
Lord Kirkwood of Kirkhope
Baroness O'Loan
Baroness Redfern
Lord Sherbourne of Didsbury
Rt Hon. Lord Rooker
Baroness Watkins of Tavistock

Registered interests

Information about interests of Committee Members can be found in the last Appendix to this report.

Publications

The Sub-Committee's Reports are published on the internet at http://www.parliament.uk/seclegbpublications

The National Archives publish statutory instruments with a plain English explanatory memorandum on the internet at http://www.legislation.gov.uk/uksi

Committee Staff

The staff of the Committee are Christine Salmon Percival (Clerk), Paul Bristow (Adviser), Nadine McNally (Adviser), Philipp Mende (Adviser), Jane White (Adviser), Louise Andrews (Committee Assistant) and Ben Dunleavy (Committee Assistant).

Information and Contacts

Any query about the Committee or its work, or opinions on any new item of secondary legislation, should be directed to the Clerk to the Secondary Legislation Scrutiny Committee, Legislation Office, House of Lords, London SW1A 0PW. The telephone number is 020 7219 8821 and the email address is hlseclegscrutiny@parliament.uk.

First Report

PROPOSED NEGATIVE STATUTORY INSTRUMENTS UNDER THE EUROPEAN UNION (WITHDRAWAL) ACT 2018

Proposed Negative Statutory Instruments about which no recommendation to upgrade is made

Animals (Scientific Procedures) Act 1986 (EU Exit) Regulations 2018

Communication of Investments (Revocation) (EU Exit) Regulations 2018

Merchant Shipping (Miscellaneous Provisions) (Amendments etc.) (EU Exit) Regulations 2018

INSTRUMENTS DRAWN TO THE SPECIAL ATTENTION OF THE HOUSE

Draft EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018

Date laid: 5 September 2018

Parliamentary procedure: affirmative

It is clearly important to ensure that, in a "no-deal scenario" for the UK's exit from the EU, there is minimal disruption to the UK's financial services sector when firms lose their authorisation based on the EEA passport and seek instead to be authorised by the UK's regulatory bodies, the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA). By providing for a "temporary permissions regime", these draft Regulations seek to achieve that objective.

Information provided by HM Treasury (HMT) indicates the scale of the task that the PRA and FCA may face in dealing with applications for authorisation during that regime. The draft Regulations allow for the possibility that the period of the regime could be extended in the light of an assessment of progress by the regulatory bodies. We consider it sensible that the Government should be able to introduce such an extension: a decision to do so would be a matter of great interest to the House. Given the significance of any regulations to extend the temporary permissions regime, however, it may seem surprising that HMT has proposed that the negative, rather than the affirmative, procedure should apply. We wrote to the Economic Secretary to the Treasury on this point, and we are publishing his reply. The House may wish to press for a fuller justification of the choice of negative procedure than has so far been given.

We draw these Regulations to the special attention of the House on the ground that they give rise to issues of public policy likely to be of interest to the House.

1. The EEA financial services "passporting" system enables financial services firms authorised by the regulatory authorities in their home EEA member state to provide their services to customers in any other EEA member state without having to obtain authorisation from the other member states' regulatory authorities. In the Explanatory Memorandum (EM) to these draft Regulations, HM Treasury (HMT) says that, after the UK leaves the EU on 29 March 2019, the use of the EEA financial services passport would not operate effectively without a negotiated agreement with the EU; and that, as a result, the thousands of EEA firms undertaking business in the UK via an EEA financial services passport would suddenly lose their authorisation to carry out regulated activities in the UK, with disruptive consequences.

2. The draft Regulations are intended to ensure that, in a "no-deal scenario", there would be an orderly transition from the use of the EEA financial services passport to the requirement that EEA financial services firms that carry on regulated activities in the UK must be authorised by the UK's competent authorities, namely, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). The Regulations propose the creation of a "temporary permissions regime" whereby EEA firms currently operating in the UK via an EEA financial services passport are granted UK authorisation for a limited time until the PRA and the FCA determine their

applications for UK authorisation. (The instrument also removes references in UK law to the provisions that implement the EEA financial services passport.)

3. To enter the regime, prior to exit day eligible firms will need to submit either an application for UK authorisation or a notification of their intent to enter the regime. Once in the regime, firms will be required to make an application within two years from exit day if they have not already done so. Firms in the regime will be treated as though they have UK authorisation. This will enable the PRA and the FCA to have the same supervisory powers over the firms as they would with any other UK-authorised firm. The scope of the activity a firm will be permitted to undertake will be limited to the scope of regulated activities they were permitted to carry on immediately before exit day under their passport.

4. In the EM, HMT says that, in line with the duration of the regime, the Regulations extend the deadlines by which the PRA and the FCA have to make a determination on an application for authorisation from EEA firms operating in the UK via a passport, to up to three years after exit day. In addition, the instrument provides HMT with the power to extend both the length of the regime and these deadlines, by no more than 12 months at a time, in certain circumstances. There is reference to this power in the Statement at Part 2 of the Annex to the EM (at paragraph 5.2): "The power is exercisable by statutory instrument subject to annulment in pursuance of a resolution of either House of Parliament. This is considered appropriate should it transpire that, given the number and complexity of applications, they cannot all be dealt with in time, and that this would result in detrimental effects on UK consumers, firms and financial markets." The Regulations provide that HMT could use this power only after receiving an assessment of the need for an extension from the FCA and PRA at least six months before the end of the existing period.

5. We wrote to the Economic Secretary to the Treasury seeking further clarification of why the negative, rather than the affirmative, resolution procedure was being proposed for a statutory instrument that would extend the length of the regime. In his reply of 15 October (which we are publishing at Appendix 1), Mr Glen has said that the choice of procedure is appropriate since "the overall powers and purpose" will be scrutinised through these draft Regulations, and the negative procedure would be used only for an extension.

Level of applications

6. We obtained additional information from HMT about the level of applications anticipated, and the ability of the PRA and FCA to handle these; we are publishing the information at Appendix 2.

7. HMT has said that the PRA estimates it will receive approximately 160 applications for authorisation from EEA firms, many of them substantial and complex; and that this would be a significant increase by comparison with the PRA's current experience of dealing with around a dozen applications for authorisation per year, normally from start-ups or relatively small firms. As regards the FCA, HMT has told us that, in the year to 31 March 2018, the FCA processed approximately 1,200 applications for authorisation from firms (excluding consumer credit); that applications from a proportion of

the firms that passport into the UK would represent a significant increase; and that, for business planning purposes, the FCA is using an assumption of just under 1000 firms that may use the regime (in addition to the business as usual figure). HMT has said that it is content that the PRA and FCA are making adequate preparations to deal with these applications.

8. In writing to the Economic Secretary to the Treasury, we also asked about the reliability of these estimates. In his reply of 15 October, Mr Glen acknowledges that there is an unavoidable degree of uncertainty about them, but describes them as sensible working assumptions that will be kept under review.

UK firms operating in EEA after Brexit

9. We also asked Mr Glen about the position of UK firms operating elsewhere in the EEA after the UK has left the EU (albeit that this falls outside the scope of these Regulations). In his reply, the Minister refers to the implementation period which, if taken forward, would allow firms to continue to trade on the same terms as now until 31 December 2020, and also to the proposal that the UK Government have made for a new economic arrangement with the EU to manage regulatory change in the future. He acknowledges, however, that if there is no deal with the EU, unilateral action by the UK Government would not be able to influence the status of UK firms operating in the EEA.

Conclusion

10. It is clearly important to ensure that, in a "no-deal scenario", there is minimal disruption to the UK's financial services sector when firms lose their authorisation based on the EEA passport and seek instead to be authorised by the UK's regulatory bodies, the PRA and FCA. By providing for a "temporary permissions regime", these draft Regulations seek to achieve that objective. Information provided by HMT indicates the scale of the task that the PRA and FCA may face in dealing with applications for authorisation during that regime.

11. The draft Regulations allow for the possibility that the period of the regime could be extended in the light of an assessment of progress by the regulatory bodies. We consider it sensible that the Government should be able to introduce such an extension, and we think that a decision to do so would be a matter of great interest to the House. Given the significance of any regulations to extend the temporary permissions regime, however, we do not see it as self-evident that such an instrument should be subject to the negative, rather than the affirmative, procedure, as HMT has proposed. **The Economic Secretary to the Treasury has stressed that HMT would be able to modify the time limits only if it considered it necessary to do so. While accepting that this would be the case, we take the view that the House might well wish to debate such a necessity, and that it may also wish to press for a fuller justification of the choice of negative procedure than has so far been given.**

INSTRUMENTS NOT DRAWN TO THE SPECIAL ATTENTION OF THE HOUSE

Instruments subject to annulment

SI 2018/1004	Vehicle Drivers (Certificates of Professional Competence) (Amendment) (EU Exit) Regulations 2018 (Nadine)
SI 2018/1025	Timber and Timber Products and FLEGT (EU Exit) Regulations 2018
SI 2018/1034	Seal Products (Amendments) (EU Exit) (Regulations) 2018
SI 2018/1039	Friendly Societies (Amendment) (EU Exit) Regulations 2018

APPENDIX 1: CORRESPONDENCE ON THE DRAFT EEA PASSPORT RIGHTS (AMENDMENT, ETC., AND TRANSITIONAL PROVISIONS) (EU EXIT) REGULATIONS 2018

Letter from Lord Trefgarne, Chairman of the Secondary Legislation Committee, to Mr John Glen MP, Economic Secretary to the Treasury

The Committee gave a first consideration to these draft Regulations at its meeting on 9 October. A number of questions arose, and we would be grateful if you could reply to these in advance of our next meeting.

We received information from your Department about the likely volume of applications that the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) might receive under the "temporary permissions regime" proposed under these Regulations.

Against a total number of some 7,700 EEA-based firms now registered to passport into the UK, we were given an estimate of some 160 applications that the PRA might receive, while we were told that the FCA is assuming that just under 1,000 firms may wish to use the new regime. The level of applications will be a critical factor for the ability of the PRA and FCA to operate the new regime. Have the estimates that we were given been further refined and, if not, are you confident that these estimates are a sound basis for planning?

We noted that the draft Regulations propose to give your Department the power to extend the length of the regime, by no more than 12 months at a time, in certain circumstances; and that this power would be exercisable by statutory instrument subject to negative resolution. Such an extension could well attract much Parliamentary interest: can you say more about why you consider that the negative procedure is appropriate in this case?

Finally, the draft Regulations relate to the position of EEA firms operating in the UK. While this is of course outside the scope of the Regulations, please could you say what you anticipate will be the position of UK firms operating elsewhere in the EEA once the UK has left the EU?

10 October 2018

Letter from Mr John Glen MP to Lord Trefgarne

Thank you for your letter concerning the draft EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018, which were laid before Parliament on 5 September.

You firstly asked about the number of applications for full UK authorisation that the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA) have estimated they will receive from EEA firms. The estimates my department provided you last month do carry with them an unavoidable degree of uncertainty. However, they reflect my officials' consultation with the regulators and are sensible working assumptions that will continue to be kept under review. I am confident that both the PRA and the FCA are making adequate preparations and effectively allocating resources ahead of March 2019 and the start of the temporary permissions regime. The draft regulations are designed to provide the regulators with the discretion to operationalise the regime as is necessary to discharge their regulatory functions. For example, the FCA- who are expecting many more applications than the PRA- will issue firms in the regime with a

specific time period in which to make their application (a 'landing slot'), which will further enable the FCA to manage the flow of applications appropriately.

These applications are made and assessed through the same procedure as usual applications for full UK authorisation. A notable difference, in a no-deal scenario, is the expected increased volume of applications as EEA firms that currently operate in the UK via a passport will be required to seek authorisation from the PRA or the FCA to continue operating in the UK. In addition, this will include applications from large and complex businesses with a substantial UK presence. The regime will ensure continuity and certainty for the UK's financial services sector and its customers and will significantly reduce the operational challenges that would otherwise face the PRA and the FCA. Without this legislation, to continue operating in the UK all EEA firms would have to be granted full UK authorisation by exit day.

In the context of the uncertainty surrounding the numbers of firms that will end up joining the regime and the varying degrees in the complexity of their applications, my officials and I consider it necessary to have a power to extend the length of the regime, which would be crucial in alleviating the potential scenario that some EEA firms cannot be authorised within three years from exit day. The choice of procedure is appropriate given the overall powers and purpose are scrutinised now through this affirmative instrument, and the use of the negative procedure is for an extension alone.

The Treasury would not be able to modify the time limits set out under these regulations as a matter of course but only if it considers it "necessary" to do so. Its use of the power would also need to be based on a robust assessment from the FCA and PRA regarding the effects of extending and not extending the period on the affected firms in general, the UK financial system and the ability of the regulators to discharge their functions in a way that advances their statutory objectives.

Finally, concerning the status of UK firms operating in the EEA after the UK has left the EU, the UK and the EU have agreed the terms of an implementation period that will start on 29 March 2019 and last until 31 December 2020. During this period access to each other's markets will continue on current terms, and businesses, including financial services firms, will be able to trade on the same terms as now until 31 December 2020.

In addition to agreeing the terms of an implementation period, the government has proposed a new economic and regulatory arrangement with the EU which would expand the scope of cross-border activity beyond existing 'equivalence', and ensure structured dialogue to manage regulatory change in future. Our proposal recognises the importance of autonomous decision making for the EU and UK, alongside the need to maintain the economic benefits of the most important financial services traded between us. It is a credible and negotiable model for the future EU-UK relationship in financial services.

The government has every confidence that a deal will be reached and the implementation period will be in place. However, in the unlikely event of a no deal scenario, the UK authorities are not able through unilateral action to influence the status of UK firms operating in the EEA.

The UK government and regulatory authorities are committed to working with EU partners to mitigate any risks that might result from this.

Many UK financial services firms who currently passport into the EEA are taking steps to ensure that they could continue to operate after exit, for example, by establishing a new EU authorised subsidiary. This would allow the UK firm to offer new services after exit through its EEA subsidiary, and in some cases existing contracts could be transferred to the new entity.

I hope this is helpful.

15 October 2018

APPENDIX 2: DRAFT EEA PASSPORT RIGHTS (AMENDMENT, ETC., AND TRANSITIONAL PROVISIONS) (EU EXIT) REGULATIONS 2018

Additional Information from HM Treasury

Q1: What estimate has HMT—or FCA and PRA—made of the likely volume of applications?

A1: There are approximately 7,700 EEA-based firms that are registered to passport into the UK.

The PRA estimates it will receive approximately 160 applications for authorisation from EEA firms looking to continue performing regulated activities in the UK following the cessation of passporting. Many of these firms are very substantial and complex, including several globally-systemic institutions. The PRA will continue to engage firms on their planning in relation to EU withdrawal; as a result, the final number of applications may vary slightly. The FCA will also play a role in the authorisation of these 'dual regulated' firms.

For 'solo-regulated' firms—whose applications will be handled by the FCA only—the FCA expects the total number of applications for UK authorisation from firms to be lower than suggested by the total population of registered EEA firms because it is likely that the number of firms that actually use their passports here is much lower and the number of those firms that will wish to join the TPR could be smaller still. It is therefore very difficult to estimate the number of applications the FCA will receive. The FCA is currently running a survey of passporting firms to achieve a more accurate picture of expected applications.

Managing the volume of applications is just one element of the temporary permissions regime. Other important benefits include ensuring continuity for customers and avoiding cliff edges.

Q2: How does this compare with the business as usual, pre-Brexit volume of applications?

A2: This is a significant increase. To put this into context, and as Sam Woods (Deputy Governor for Prudential Regulation at the Bank of England's Prudential Regulation Authority) noted to the Treasury Select Committee in December 2017, in the first four years of the PRA's existence, the PRA authorised 48 new firms. That equates to around a dozen applications for authorisation per year, normally from start-ups or relatively small firms. This compares to an expected approximately 160 EU withdrawal-related authorisations applications.

The FCA deals with a higher volume of applications than the PRA. In the year to 31 March 2018, the FCA processed approximately 1,200 applications for authorisation from firms (excluding consumer credit). Applications from a proportion of the firms that passport into the UK would therefore represent a significant increase.

For business planning purposes the FCA is using an assumption of just under 1000 firms that may use the regime. This number is in addition to the business as usual figure. For firms currently using a services passport the FCA will also be less familiar with the firms in question as they will be supervised and regulated in their home state, potentially making the authorisation process more complex.

Given uncertainty regarding both factors, in the absence of the implementation period the temporary permissions regime would help avert a potential cliff edge.

Q3: What organisational preparations are being made by FCA and PRA to deal with the applications?

A3: As Sam Woods (Deputy Governor for Prudential Regulation at the Bank of England's Prudential Regulation Authority) noted at the Treasury Select Committee on 20 December 2017, the PRA has been preparing for the significant challenge of authorising the approximately 160 solo-regulated EEA firms expected to apply for authorisation. The PRA has 45 staff in place dealing with these issues with firms, with another 40 to 55 of the PRA's staff supporting (although not exclusively), on this issue. The PRA has also reprioritised some of its activities to ensure the right resources are focused on its authorisations work.

The FCA has also put in place additional resource to assess the applications received so far from dual-regulated firms and has plans to allocate further resource to assess applications from funds and solo-regulated firms as necessary. The temporary permissions regime and the ability to assign 'landing slots' to firms to submit their applications in staggered windows is a key part of enabling the FCA to manage the flow and operational impact of these applications. The FCA plans to give further details of how this process will work in a consultation paper later in the year.

The FCA and PRA have set out further details of how they intend to make use of the powers that would be provided to them as part of the regime, pending Parliamentary approval of the legislation [https://www.fca.org.uk/news/statements/fca-role-preparing-for-brexit & https://www.bankofengland.co.uk/news/2018/july/temporary-permissions-and-recognition-regimes].

Q4: Is HMT content that those bodies are making adequate preparations?

A4: Yes.

Q5: Will these matters be dealt with in the Impact Assessment: when the IA will be published?

A5: The estimated volume of applications expected by the PRA and FCA is not explicitly covered in the Impact Assessment, because this is a direct consequence of UK withdrawal and not an impact associated with the statutory instrument itself.

We do not currently have an estimated date for when the impact assessment will be published, since this depends on when we receive an opinion from the Regulatory Policy Committee.

11 September 2018

APPENDIX 3: INTERESTS AND ATTENDANCE

Committee Members' registered interests may be examined in the online Register of Lords' Interests at http://www.parliament.uk/mps-lords-and-offices/standards-and-interests/register-of-lords-interests. The Register may also be inspected in the Parliamentary Archives.

For the business taken at the meeting on 16 October 2018, Members declared no interests.

Attendance:

The meeting was attended by Lord Cunningham of Felling, Baroness Donaghy, Lord Goddard of Stockport, Lord Kirkwood of Kirkhope, Baroness O'Loan, Baroness Redfern, Lord Sherbourne of Didsbury, Lord Rooker and Baroness Watkins of Tavistock.