



RESPONSE TO HM TREASURY'S PHASE II CONSULTATION – FINANCIAL SERVICES FUTURE REGULATORY FRAMEWORK REVIEW

The Association of Foreign Banks (AFB) represents the interests of the foreign banking sector in the UK to industry stakeholders, including the Government, regulatory bodies and financial services organisations. The AFB's membership consists of approximately 200 international banking group members, representing around 80% of the UK's foreign banking market, providing financial services through branches, subsidiaries and representative offices. The AFB welcomes the opportunity to respond to the Phase II consultation (the "Consultation").

INTRODUCTION

We note HM Treasury's (HMT's) objective is to establish a bespoke financial services post-EU regulatory framework, as opposed to pursuing a regulatory agenda which prioritises rule convergence for equivalence purposes. In this context we welcome HMT's support for a regulatory framework based on the Financial Services and Markets Act 2000 ("FSMA"), which we believe is the correct approach. We agree with the proposed updating of the allocation of regulatory responsibilities set out in chapter 2 of the Consultation, including the greater responsibility to be given to the Financial Conduct Authority and the Prudential Regulation Authority (the "Regulators") and the introduction of activity-specific regulatory principles to enable HMT and Parliament to direct the regulators to have regard to specific public policy issues. We also agree with the objectives set for the Future Regulatory Review set out in paragraph 2.40 and the proposal in paragraph 2.41 to review the FSMA cross-cutting regulatory principles.

More broadly, the view of our members is that, when considering how the post-EU regulatory framework should develop, the focus should be on the following areas: (a) the overall approach to post-EU financial services regulation and legislation; (b) the accountability and scrutiny of the Regulators; (c) the role of the Regulators within the post-EU financial services framework; and (d) critically, the preservation of the UK as an attractive centre for international firms. Please see our comments below.

GENERAL COMMENTS

A. THE OVERALL APPROACH TO POST-EU FINANCIAL SERVICES REGULATION AND LEGISLATION

Post Brexit, following the loss of the relatively transparent EU system of legislation, the UK will need to ensure that it establishes a system of high-quality, predictable, stable, expert and cost-effective regulation and legislation. We believe these objectives should form the basis on which a review of the future financial services framework should begin.

The UK has been a key contributor to the creation of international regulatory standards for many years, and its regulatory framework should therefore explicitly aim to be in line with those international standards, and not extend beyond them. This is vital if the UK is to remain an attractive jurisdiction for international financial institutions to conduct business activity. Consequently, any future regulatory framework should also aim (as a default position) to remove (over time) any additional regulation which goes beyond accepted international standards. To support this objective, we believe that HM Treasury should invest significantly in international standard-setting bodies (such as IOSCO and FATF), which are responsible for setting international standards for financial services regulation and promoting the application of those standards.

As part of the process of creating and developing international regulatory standards, we recommend that HMT and the Regulators should engage with international counterparts in the following ways:

- seek dialogue with international counterparts from the beginning of the process of introducing new regulations, rather than retrospectively once legislation is enacted
- seek greater coordination on timetables with international counterparts
- identify key issues early, particularly in relation to extra-territoriality
- cooperate and develop mechanisms and processes for identifying and managing conflicts between jurisdictions
- ensure there is proper recognition of the rules in operation in other jurisdictions where those rules are essentially equivalent (Note: any mutual recognition of these rules should focus on the regulatory outcomes, rather than the details of the rules themselves)

B. ACCOUNTABILITY AND SCRUTINY OF THE REGULATORS

The proposed post-EU financial services framework will naturally involve a substantial delegation of responsibility for the development and implementation to the Regulators and we agree that this must be matched by the increased accountability and scrutiny of those parties.

We also believe that the review of: (a) regulatory and rule-making processes for new regulations; and (b) existing rules should be strengthened in order to improve accountability.

We support the proposal in the Consultation that Parliament should take an overall role in scrutinising the actions of the Regulators and their proposed rules. The calling and holding to account of Treasury Ministers and the Regulators via the parliamentary select committee system should in general provide sufficient parliamentary scrutiny of the work of the Regulators. However, we believe that HMT should, when considering this aspect of its review, also consider the balance that needs to be struck between scrutiny of the work of the Regulators with the risk that their rulemaking and actions are, or become, overly politicised. Regulation needs to develop in line with long-term policy objectives and whilst it should react to specific developments, this should not become only influenced by shorter-term political considerations.

We further believe that the future regulatory framework should also include a specific mechanism through which regulated firms and their representatives can challenge the approach taken and the rulemaking of the Regulators. We welcome HMT's focus on this specific aspect of scrutiny in the Consultation. In our view, the representation of industry stakeholders must be incorporated into HMT's focus on accountability, so that there exist forums in which the Regulators' proposed rules and policies are debated by industry practitioners to ensure those rules and policies are practicable and the ongoing impact of the introduction of a set of rules can be assessed.

Accordingly, we recommend that the review also looks at the existing consultation processes for the introduction of new rules/approaches in order to make it possible in a transparent way for institutions and their representatives to advocate for changes to the Regulators' proposed rules. In our view each

introduction of new rules or the amendment of on shored legislation requires the active participation of industry stakeholders with sufficient expert knowledge. This is already taking place to some extent but it would be beneficial if consideration of the detailed processes could be a specific topic for a roundtable of industry stakeholders as part of the review.

We support in general the recommendations relating to accountability and scrutiny made in chapter 3 of the [IRSG/Linklaters report](#) entitled 'The Architecture for regulating finance after Brexit' dated 23 January 2020 (the "Report").

In particular, we consider that the following recommendations on accountability and scrutiny of the Regulators (set out in chapter 3.3 of the Report) should be a focus of attention:

- strengthening the role of the PRA and FCA statutory panels
- making review mechanisms mandatory for new rules and legislation after a specific period of time
- the establishment of a Financial Regulatory Policy Committee
- the establishment of a Joint Regulatory Committee

We believe that these proposals would address the deficiencies raised in the Report and enhance the regulatory architecture of UK by building on existing mechanisms. Specifically, AFB members would favour the introduction of a systematic review of the rules led by the Regulators themselves, with additional resources being made available to the Regulators to conduct such reviews.

By way of example, we would highlight the following as being rules brought into UK law in recent years, which would have benefited from a review being carried out two years after implementation: MiFID II (costs and charges, research and product governance provisions), PRIIPs, MAR (market soundings) and Solvency II.

Other measures are subject to longstanding and ongoing review at EU level and the UK would have benefitted from reviewing them in parallel. These include the Investment Firms Directive/Regulation on regulatory capital and remuneration (where the UK's approach to date has been about how to implement the EU regime rather than whether it is fit or purpose) and MAR (where topics such as market soundings and pre-hedging are the subject of ongoing debate at EU level which is not being replicated in the UK). A number of these sets of rules are of course now being looked at, following the end of the transition period, but we would argue that each new set should be subject to a broad review in accordance with a fixed timetable taking into account the rulebook as a whole.

Accordingly, we recommend that HMT draw up with the Regulators a set of guidelines for such reviews for discussion with stakeholders at one of the forthcoming roundtables. With reference to paragraph 3.50 of the Consultation, we do not think that such reviews should have to be carried out by an independent reviewer, but rather by the regulators themselves, as they should set the agenda using a peer review method.

The overall aim of such reviews should be a pragmatic appraisal of the effectiveness and impact of any new rules, taking account of the practical experience of industry stakeholders and consumers after a specified time period. This focus on adapting rules based on experience in a timely manner would deliver practical benefits and enhance the reputation of the UK regulatory framework.

C. THE ROLE OF THE REGULATORS WITHIN THE POST-EU REGULATORY FRAMEWORK

Although we agree that the Regulators should be granted considerably more responsibility in relation to rule-making as part of the post-EU framework, we are concerned by HMT's initial analysis that EU-derived legislation should all be transformed into regulatory rules so that the Regulators can take ongoing responsibility for maintaining and adapting the rulebook.

In our view the logical reason for granting the Regulators greater responsibility and authority with regard to rulemaking is to allow and facilitate managed amendments to EU-derived legislation. In our view the Regulators should be able to review the EU-derived legislation themselves over a specific time period agreed with HM Treasury, retaining that which it deems suitable and discarding requirements which are unnecessary, out of date, or which do not reflect properly the UK's role as an international financial centre. Further, as the EU's rules will evolve over time, we consider it critical that HM Treasury makes clear that when EU rules change in the future, the UK may, but may not, reflect those changes in its rules, or may conduct its own full review of areas being reviewed by the EU, such as MiFID, MAR, IFD/R, BMR etc, and that the Regulators should make these choices for the UK in line with the powers delegated to them once the review is complete.

D. THE UK AS AN ATTRACTIVE FINANCIAL CENTRE

The Consultation acknowledges the UK is an international financial centre and expresses clear support for the UK maintaining its international standing after Brexit. We believe the following key principles underpin all international financial centres and should be central tenets of the UK's approach to financial services legislation following Brexit:

- differentiation between retail markets and wholesale markets
- avoidance of regulatory fragmentation
- openness towards wholesale actors and capital flows
- importance of liquidity
- efficiency

In this context we believe that in the post-EU framework the Regulators need to balance their instincts to regulate domestic business closely which is of importance to UK based customers, and the role of the UK as an international financial centre comprising of institutions which have specifically chosen the UK, and more specifically London, as a location to conduct business activity. Domestic concerns and international concerns are separate priorities, and we believe they need to be treated as such. The concept of competition is central to this balancing act, and we note that it is relevant for both domestic and international concerns. It is right that the Regulators should focus on promoting competition to protect UK based customers, however this should not overshadow the Regulators' additional responsibility to promote the UK's competitiveness on the international stage.

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