Brexit Quick Brief #7

UK FINANCE

The EU (Withdrawal) Bill - providing certainty and continuity

Key points

- The EU (Withdrawal) Bill will confirm the continued application of EU law already on the UK statue book and create UK legal instruments to replicate EU rules which currently have direct effect in the UK. In its White Paper, published on 30 March 2017, the Government set out how it will use the EU (Withdrawal) Bill to achieve this.
- EU law covers many areas including environmental regulation, workers' rights, and the regulation of financial services. Without the EU (Withdrawal) Bill, when the UK leaves the EU, many of these rules and regulations would no longer have legal standing in the UK. This is especially the case for EU regulations, which apply directly to the UK from the EU level and have not been transposed into UK law.
- Rather than producing in UK statute all EU Regulations, the EU (Withdrawal) Bill will codify the continued applicability of these and the rest of the EU acquis in the UK at the point of exit. This approach is efficient and (i) reduces the risk of a legal vacuum; (ii) provides the basis for a considered review of policy in the future: (iii) maintains a close alignment between the UK and the EU in the first instance while a new trade deal is negotiated: and (iv) maintains the UK regulatory and policy framework needed to facilitate transitional arrangements.
- Secondary legislations is intended to be used to deal with the majority of corrections that will be needed to ensure existing laws remain operable. The use of secondary legislation is an accepted practice that has worked well for technical areas of legislation or regulation, including in financial services.
- For the banking sector, there are a wide range of EU rules already in UK law and practice that will require stocktaking and confirmation for a future UK regime. A number of EU frameworks will also need to be confirmed as applying in the UK to ensure a smooth transition for UK-based banks, both foreign and domestic.
- In addition to the EU (Withdrawal) Bill a number of other Bills were announced in the Queen's speech in June 2017 in relation to the UK exit from the EU and which may impact the banking sector. These additional flanking bills will relate to customs, trade, immigration, fisheries, agriculture, nuclear safeguards and international sanctions. This additional primary legislation is required where a process of transposition is not adequate to create a robust new UK framework.

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The EU (Withdrawal) Bill and its purpose

Exiting the EU will require the transposition of EU law onto the UK statute book to preserve the greatest possible continuity at the point of exit.

Exiting the EU will inevitably impact on UK law and the UK statute book. After more than four decades of EU membership the UK is subject to a wide range of legal powers or other forms of governance implemented directly at the EU level. Extracting the UK from this complex legislative arrangement and practice is one of the basic challenges of an orderly transition out of the EU.

The scale of this task is illustrated by the House of Commons' Library estimate that 13.2% of UK primary and secondary legislation enacted between 1993 and 2004 was EU-related. The proportion in subsequent years, according to a recent study by the Hansard Society[1], has been even larger with 17.2% of statutory instruments laid before Parliament in the 2015-16 session being derived from EU law.

Without the EU (Withdrawal) Bill, when the UK leaves the EU all these rules and regulations would no longer have legal standing in the UK, creating a "black hole" in the UK statute book and the risk of legal vacuum.

The purpose of the EU (Withdrawal) Bill is to preserve all the existing UK laws that have been made to implement EU obligations and to covert directly applicable EU law into UK law. This will ensure that current UK rules remain stable in the short term and that EU rules currently applied have clear UK equivalents at the point of exit. The EU (Withdrawal) Bill will also repeal the European Communities Act 1972 which establishes the primacy of EU law in the UK.

While the UK Government has indicated that amendments to this inherited body of EU law are likely in the future, confirmation and transposition are designed to ensure the greatest possible legal continuity at the point of exit. This will also be important for areas where the EU may choose to recognise UK law or practice in certain respects or adapt its own practice to accommodate the UK. This will only be possible if there is a high degree of stability in the UK statute book.

The practical challenge of stocktaking UK law

It will be necessary to draft new primary legislation in a number of key areas that do not involve the transposition or confirmation of EU law, but the establishment of autonomous UK practice outside of the EU.

The preliminary challenge for the EU (Withdrawal) Bill as currently proposed breaks down into three elements:

- Sifting current UK law for references to EU law or EU authority that require excision or amendment;
- Determining whether any law needs to be corrected in order to be operable and/or whether that may involve new primary legislation;
- Identifying the gaps in UK law that will be created by the discontinued application of the EU rules – and determining how to fill these gaps.

Some of these questions may be relatively simple – for example replacing the powers of an EU agency with a UK equivalent. Others may be more complex – involving UK obligations to other EU Member States or the EU institutions (such as the European Central Bank and the European Investment Bank) that will be hard or impossible to honour as a third country outside the EU.

Creativity may be required for some – for example, the transposing of powers granted to an EU institution where no equivalent regulatory body currently exists in the UK or where an existing UK regulatory body is designated that does not currently have the developed regulatory framework to implement these. The supervision of UK based rating agencies, which is currently undertaken by ESMA, is an example of this. Others may need to reflect the unfolding negotiation between the UK and the EU or the scope of transitional arrangements negotiated between the UK and the EU27. In these latter cases in particular, the legislative process will require an element of both flexibility and speed.

It will also be necessary to draft new primary legislation in several key areas that do not involve the transposition or confirmation of EU law, but the establishment of autonomous UK practice outside of the EU. For example, any new UK migration regime is likely to require new primary legislation, as will establishing any new external customs tariff and customs protocols. In both cases these frameworks may need to be in place at the point of exit, depending on the possible scope of transitional arrangements between the two sides.

The process of codification of all EU regulations

[1] Hansard Society Insight (2017): Parliament and Delegated Legislation in the 2015-16 Session.

reduces materially the scale of what is a large exercise. It will however still place intense strain on the time of Parliament. It is almost certainly not feasible that Parliament itself could review and amend every piece of UK primary legislation implicated in this process. For this reason, the current UK Government signalled that the EU (Withdrawal) Bill will grant Ministers the power to change primary legislation via secondary legislation rather than enacting detailed statutory provisions.

Box 1: The role of secondary legislation

Because of the sheer volume of change required, clauses with Henry VIII powers in the EU (Withdrawal) Bill are likely to be significant and provide wide scope for secondary legislation. The priority will be balancing proper scrutiny by Parliament and the need to expedite the revision of legislation. Consequently, it is possible that Parliament will conclude that it's resources should be focused above all on areas where the UK is producing new primary legislation and new roles or protocols for regulators – areas where judgements are being made about future UK policy or processes.

This balance will be important in banking and financial services. Secondary legislation has been frequently used in financial services legislation, where changing market contexts can require frequent amendment of technical detail in rule-making. For example, there are over 200 statutory instruments that have been made under the Financial Services and Markets Act 2000. In general, such practice has worked well. For the same reason, financial regulators often use amendments to their rulebook and policy statements to provide guidance to businesses as to how they should interpret law or adapt practice to meet regulatory expectations. This also happens at the EU level via the delegation of powers to agencies such as ESMA.

In the context of the EU (Withdrawal) Bill there will be a clear and important role for regulators such as the PRA and the FCA in both helping define the UK Government's aims and in translating the UK Government's approach into clear guidance for businesses through policy statements and clear, transparent evolutions in the regulatory rulebook. These tools have an important role to play in helping policymakers strike the balance between full Parliamentary scrutiny of major change and flexibility in clarifying elements of detail or providing guidance to firms through a period of change. Transparency and close consultation with the banking and financial services sector will be especially important in many of these areas to assist in the proper implementation of the task of transposition and reduce the risk of accidental errors.

There will be an important role for regulators such as the PRA and the FCA in both helping define the UK Government's aims and in translating the UK Government's approach into clear guidance for businesses.

Transparency and close consultation with the impacted industries will be important to assist in the implementation of the task of transposition and reduce the risk of accidental errors

Delegations of authority can be expected to be closely scrutinised by Parliament as they will materially shape Parliament's role in defining the outcome.

These delegated powers could, for example, enable the UK Government to give effect to the outcome of the negotiations with the EU, change EU-related legislation to match the UK Government's policy objectives and amend or qualify EU legislation so that it functions effectively after the UK exit from the EU becomes effective. Instruments granting the UK Government this broad role are sometimes known as 'Henry VIII' clauses. These delegations of authority can be expected to be closely scrutinised by Parliament as they will materially shape Parliament's role in defining the outcome. Given the unprecedented nature of this task, there is likely to be a healthy debate regarding the extent of delegations and the manner by which Parliament is to exercise effective oversight (See Box 1: The role of secondary legislation).

A further practical question will arise with respect to the role of the UK's devolved administrations in the EU (Withdrawal) Bill process. Both the Scotland Act 2016 and the Wales Act 2017 oblige the UK Government to seek the consent of administrations when legislating on devolved issues, including many issues implicated in the changes brought by the EU (Withdrawal) Bill. It is possible that both administrations will require their own variants of the EU (Withdrawal) Bill.

What would the EU (Withdrawal) Bill mean for the banking sector?

Like most other UK sectors, the UK banking sector will be heavily impacted in the EU (Withdrawal) Bill process, and will be a microcosm of the various types of legislative transposition challenges summarised above. Some of these implications flow from EU frameworks such as data protection, corporate governance and competition law that are not specific to financial services; others from banking-specific rules.

Box 2: The EU (Withdrawal) Bill and the example of the EU Markets in Financial Instruments (MIFID/MIFID II/ MIFIR) regime

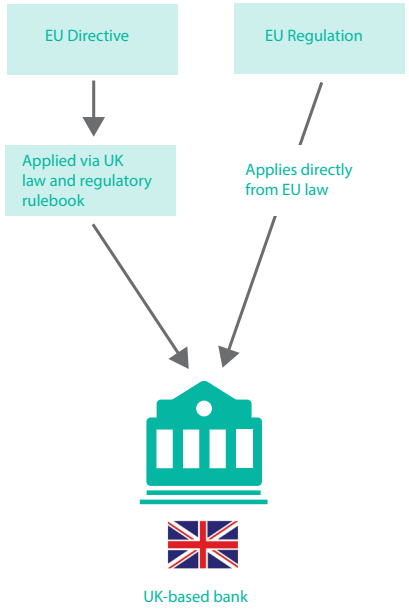
The Markets in Financial Instruments Directives (MIFID and MIFID II) and incoming Regulation (MIFIR) are implemented through the Financial Services and Markets Act 2000, with some content in primary legislation and some enacted through statutory instruments and FCA rules.	
Task for EU (Withdrawal) Bill	**MIFID/MIFIR implications**
Simple confirmation of EU standards. Some EU laws already transposed into UK law and practice may need only small technical changes to language or references. Policy content remains constant. In these cases, the EU (Withdrawal) Bill will probably include provisions to make cosmetic, technical amendments via secondary legislation, especially where legislation was initially enacted through secondary legislation such as statutory instruments.	Some aspects of MIFID and MIFID II have been transposed (or are being transposed) into UK law and practice via the Financial Services and Markets Act 2000 and the rulebook of the UK FCA and PRA. Where these rules do not reference EU standards or depend on the actions of EU agencies they may need little alteration.
More complex amendment of UK law. In some cases EU rules will span both regulations and directives, and be implemented through both primary and secondary legislation in the UK. In these cases, new primary law may be needed to replicate EU regulations, and substantive roles for EU agencies may need to be revised.	The aspects of MIFIR applying directly from the EU may need confirming as applying in the UK via in UK primary legislation and roles for EU agencies such as ESMA will need to be reallocated to UK equivalents. The EU (Withdrawal) Bill could grant the Government powers to do this by secondary legislation.
Major legislative change. Some major EU regulations currently applying directly from the EU will need to be fully replicated in the UK in a way that is consistent with UK law and which maintains the intent of the original policy. These may need new regulatory bodies or additional powers for existing regulators. The EU (Withdrawal) Bill could grant the power to achieve this through secondary legislation, but in these areas close scrutiny will be especially important.	Financial instruments regulation covering areas such as pre-trade price transparency and post-trade reporting currently apply directly from the EU via the regulation and may need replicating in UK law. The MIFID/MIFIR regime also includes the capacity for foreign firms to be recognised and granted rights in the EU market on the basis of judgements made by EU regulators: this mechanism may need to be redesigned for a UK context. This could be done by reproducing this law in the UK statute book, or potentially by referencing EU law in UK law as applicable in the UK, subject to any necessary qualifications or issues of interpretation required where EU law refers to EU agencies or other obligations or rights no longer applicable in or to the UK.
In all cases it will be necessary to ensure that progress in these areas is aligned with any agreements between the UK and the EU on transitional arrangements that effect the continued application of EU rights and obligations to the UK for a temporary period.	

UK legislation on banking, primarily in the Banking Act 2009 and the Financial Services Act 2012, reflects a combination of the conclusions of the 2008 Independent Commission on Banking, international standards agreed in the Basel Committee on Bank Supervision and the EU rulebook. The legislation provides significant powers to the Prudential Regulatory Authority and the Financial Conduct Authority, as well as recognising the power of the European Banking Authority (EBA) to set technical standards. Legislation to regulate market infrastructure and investment services that banks rely on or provide is implemented through amendments to the Financial Services and Markets Act 2000, and statutory instruments under this Act will be the main legislative vehicle for implementing the second Market in Financial Instruments Directive.

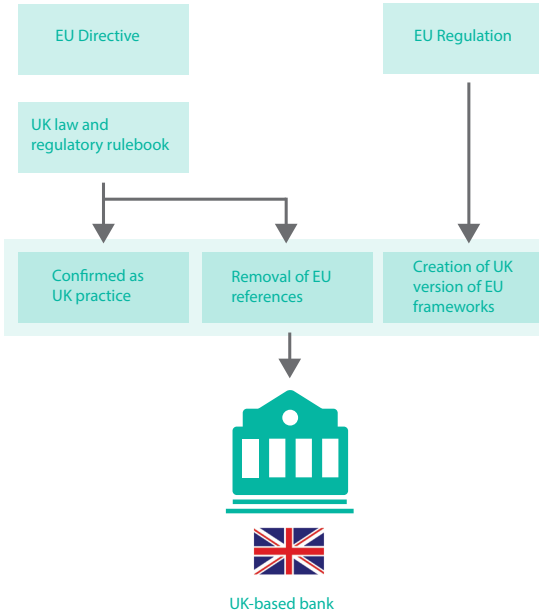
The UK is also subject to a number of directly applicable European rules on banking, including the EU's basic framework for market infrastructure, the European Market Infrastructure Regulation and similar regulations on capital requirements, the regulation of investment firms and the EU's incoming general data protection regulation .

The EU (Withdrawal) Bill implies the confirmation in UK law of regulation derived from EU frameworks, and the drafting of new UK legislation to establish in the UK legal frameworks that reproduce rules currently applied directly from the EU.

Status Quo



Withdrawal Bill process



The EU (Withdrawal) Bill process for banking

The EU (Withdrawal) Bill aim is to ensure legal continuity and avoid disruption to business, consumers, markets and the economy.

The EU (Withdrawal) Bill implies the confirmation in UK law of regulation derived from these EU frameworks, and the drafting of new UK legislation to establish in the UK legal frameworks that confirms the continued application of rules currently applied directly from the EU. Where this legislation currently grants powers to EU agencies such as the EBA or ESMA, these powers will probably need to be reallocated to UK regulators or agencies, although the precise role of EU regulators in the UK and of UK regulators in EU supervisory bodies is a question for the negotiation between the UK and the EU.

In a number of areas these EU frameworks also confer rights and obligations for third country banks in the UK that will need to be reconfirmed in UK law and practice. For example, the recognition of US market infrastructure, data protection and prudential rules as equivalent to those of the EU is currently confirmed at the EU level, and has material implications for US firms operating in the UK. The UK's new regime will need the capacity to confirm these recognitions at a UK level in a timely and consistent way (See BQB #8: External trade policy and a UK exit from the EU – clarifying the UK's WTO profile and beyond).

In general, the EU (Withdrawal) Bill process (as currently proposed) would require a careful sequencing of decisions on how to maintain continuity for UK-based banks. The priority for any Government should be to provide as much stability as possible, both for business continuity and to facilitate market access discussions with the EU and around the world.

Transposing a changing EU acquis

Throughout the exit process and the design and implementation of the EU (Withdrawal) Bill the UK regulators have an important role to perform.

It is important to note that the EU acquis will itself change during and after the exit negotiations, and maintaining close regulatory cooperation throughout the passage of the EU (Withdrawal) Bill, its secondary legislation and further updates will be necessary to maintain trust and confidence in both the UK and the EU and in the stability of the financial system.

Throughout the exit process and the design and implementation of the EU (Withdrawal) Bill the role of UK financial regulators will be key in three respects.

- The first will be simply to provide a flow of policy statements and guidance to firms as to how to understand and interpret their obligations through a period of uncertainty.
- The second will be in its established role of using such policy statements in similar ways to secondary legislation in interpreting and adding a level of detail to the direction provided by primary legislation. For example, this could include providing clarity on how the regulators plan to undertake any roles translated to them from European equivalents by the EU (Withdrawal) Bill.
- Finally, UK regulators have an important role to play in advising the UK Government on how to respond to future changes in EU regulation both before and after exit and how or whether these too should be reflected in UK legal frameworks designed for the period after the UK has left the EU. This will be a question of judging what may be desirable or required for future alignment with the EU – and how regulators should work with industry and policymakers to determine this.

Table 1: The EU (Withdrawal) Bill – key terms

The EU (Withdrawal) Bill	The legislative instrument that will be used to repeal the European Communities Act 1972 and transpose EU law into UK domestic law where it is not already present.
The Acquis Communautaire	The acquis communautaire (the EU acquis) is the total body of accumulated law and regulations of the EU, including the jurisprudence of the Court of Justice of the European Union interpreting that law.
Primary legislation	Also known as an Act of Parliament, primary legislation must be scrutinised by Parliament and is the basic framework of UK law. Primary legislation can contain a range of clauses creating powers for the UK Government to make further law via secondary legislation, including via the amendment of primary legislation itself – where such clauses create wide ranging rights with respect to the revision of primary law, they are sometimes referred to as 'Henry VIII' clauses.
Henry VIII clause(s)	A clause, or set of clauses, within a piece of primary legislation that grants the government powers to amend primary legislation using secondary legislation. This process enables quicker amendments to be made to UK law, but reduces the scope of parliamentary scrutiny of such changes.
Secondary legislation	Also known as delegated legislation, secondary legislation allows the UK Government to make changes to a law without needing a new Act of Parliament. These changes can range from technical fine-tuning to more substantive detail on the implementation of an Act. Unlike primary legislation, secondary legislation is subject to judicial review and can be ruled invalid by the courts if it is found to fall outside the powers of the parent Act.
Statutory instruments	Statutory instruments (SIs) are a type of delegated legislation. In excess of 3,000 SIs are issued each year, making up the bulk of delegated legislation. About two-thirds of SIs are not actively considered before Parliament and simply become law on a future date. SIs are usually drafted by the relevant UK Government department after consultations with interested bodies and parties.

Affirmative and negative procedures	SIs receive scrutiny and approval in Parliament through one of these two procedures. Under the negative procedure, the SI is made into law and laid before Parliament and remains in force unless Parliament votes to annul the regulation. Such annulment is exceedingly rare. Under the affirmative procedure, Parliament has to approve the SI before it becomes law. Neither process allows for Parliament to amend SIs once they have been tabled.
Policy statements and guidelines	UK Government departments issue guidance to independent regulators on priorities, which could include the approach to co-operation with EU regulators and supervisors. Regulators themselves can issue policy statements that update their 'rulebooks' and can have similar effect to statutory instruments.
European Communities Act 1972	The European Communities Act is the legislation that brought the UK into the EU. It gives EU law primacy over UK domestic law.
EU Directive	The most common kind of EU legal act, a directive is applicable to all EU Member States and lays down goals that each country must achieve. Individual countries then develop their own legislation to achieve the aims. Much EU legislation has already been transposed into UK law via this process.
EU Regulation	An EU Regulation is a binding legal act which applies at a national level and is enforceable by law in all Member States. Individual states do not need to develop legislation to bring EU regulations into force.
Competent authorities	EU derived legislation frequently names specific regulators such as the European Securities and Markets Authority (ESMA) as the competent authority to set, monitor and enforce technical rules. These authorities are unlikely to remain the relevant regulators after the UK exit from the EU.
Recognition and equivalence	Legislation can include clauses relating to the recognition of other jurisdictions' regulation, whether as a condition of market access rights or to provide certainty to firms operating across borders. Equivalence is one type of recognition used in EU regulation to provide market access or define operational treatment for foreign firms in certain areas and is currently under review (See also BQB#4; What is 'equivalence' and how does it work?).
Prudential Regulation Authority (PRA) and Financial Conduct authority (FCA)	Principal UK regulators for financial services overseeing implementation of, and adherence to, many EU regulations. They will have a vital role in shaping the EU (Withdrawal) Bill process; advising both banking and financial services firms and the UK Government on how to manage the transition between legislative regimes in an orderly manner.

See also

BQB # 1 Staying in or leaving the EU Single Market.
BQB # 2 An orderly exit from the EU.
BQB # 3 What is 'passporting' and why does it matter?
BQB # 4 What is equivalence and how does it work?
BQB # 5 Data protection and transfer.
BQB # 6 Time to adapt – the need for transitional arrangements.
BQB # 8 External trade policy and a UK exit from the EU - clarifying the UK's WTO profile and beyond.
BQB # 9 Impact of Brexit on cross-border financial services contracts
BQB # 10 Towards a framework for financial services in an EU-UK Trade Agreement