Building a financial regulatory system suitable for the UK in the new era

Speech delivered by Nausicaa Delfas, Executive Director of International, at the City & Financial Professional Virtual Roundtables.

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Highlights

- The ‘new era’ will be defined by developments brought about by Brexit, Covid-19 and technological and societal changes
- On Brexit, we all need to continue to prepare for a range of scenarios, to be ready for the end of the year
- On Covid-19, the regulatory agenda is moving from crisis response to supporting economic recovery
- Non-banks will be critical in enabling recapitalisation to promote growth and recovery from the pandemic

Thank you to City and Financial Global for hosting this series of webinars. I am delighted to be speaking here today.

The past few months have felt like we are already in a ‘new era’.

The impact of the coronavirus pandemic has not only changed how we all work, but has also had a profound impact on our economy. Efforts to manage the long term economic impact of Covid-19 are likely to define the regulatory agenda for years to come.

And of course, other developments will also define the ‘new era’: the changes resulting from EU withdrawal, as well as technological and societal changes.

So today I will focus on the impact of these developments on the financial regulatory system, and the opportunities they present.

But we should first address immediate challenges. So, I will start by discussing where we are on Brexit, and what we still need to do.

Approaching the end of the transition period

The UK left the EU on 31 January 2020, and we are nearly halfway through the transition period, which will end in just under 6 months' time, at 11pm on 31 December 2020. From that point, EU law will no longer apply and firms will need to be ready.

At the FCA, we have been working hard to undertake all the preparations we can to limit the potential for disruption – for example:

- Together with the Government and the Bank of England, we are ensuring that there will be a robust legal regime on day 1 by onshoring EU law to the UK statute book and our rule book, and by clarifying through use of the Temporary Transitional Power which onshoring changes firms will have to comply with from 1 January next year and which ones they will have until March 2022 to implement.

- We have introduced arrangements for temporary permission that will allow EEA firms to continue providing services and EEA funds to continue to be marketed in the UK once passporting ends, provided that the relevant notifications are made. Over 1,000 firms and over 600 fund managers have already notified us, and we will reopen the notification window on 30 September. From 2021, these EEA firms will be called to apply for permanent authorisation to replace their temporary permission. We plan to consult later this year on the approach we will take when we assess applications from overseas firms. And for those EEA firms who do not notify for a temporary permission or who do not obtain a permanent authorisation in due course, the Government has legislated to allow them to continue to service pre-existing contracts in the UK.

- We have already entered into a number of MoUs with EU and non-EU authorities to enhance supervisory cooperation.

- We have provided technical advice to the Treasury on the assessments of equivalence between the UK and the EU. We are also providing technical support to the UK Government in its trade negotiations with the EU and non-EU countries.

Equivalence decisions have not yet been made, and negotiations are ongoing. The outcome will impact on some of the post transition period risks – for example, deeming each other's regulatory frameworks as equivalent is the best way to mitigate risks of disruption from overlapping Share Trading Obligations and Derivatives Trading Obligations. Similarly, the data adequacy assessments conducted this year will impact transfers of personal data between the EEA and the UK.

Other risks are outside of our control to mitigate. For instance, where EU Member States had individually passed laws to smooth a possible 'hard' exit, some of these laws have now lapsed and there is no guarantee that new laws will be issued. So, if you intend to continue servicing customers in the EEA from 1 January 2021, you will need to have adapted your business according to the local laws and local regulators' expectations by that date, speaking to local regulators as appropriate, and obtaining permissions and repapering contracts where necessary, whilst treating customers fairly throughout.

In short, my message to you is that we all need to continue to prepare for a range of scenarios, to be ready for the end of the year. We will continue to update the FCA website and engage with you as the year progresses – and we encourage you to continue to raise issues with us.

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After the transition period

What will the financial regulatory system look like after Brexit, Covid-19 and other changes heralding this 'new era'?

Our approach going forward will be guided by our continued commitment to the highest international standards, and by what is right for the UK's markets, building on the strengths of the existing UK regulatory and legal system.

Last week the Chancellor stated [4] that the next phase of the Financial Services Future Regulatory Framework Review will look at how financial services regulation will be made in the UK after the transition period, including the role of Parliament, the Treasury, the financial services regulators, and how stakeholders are involved in the process.

One area that gives an indication of what this might look like is the UK's approach to the investment firms' prudential regime. We published a Discussion Paper [5] last week and the Government set out its plans to delegate responsibility to regulators to make detailed requirements - this delegation would be underpinned by a new framework for accountability, that is also intended to ensure that we consider equivalence and competitiveness when we make new rules.

This is consistent with our regulatory principles in FSMA and the Chancellor's remit letter [6]: that we should have regard to economic growth, competitiveness and trade, when we advance our statutory objectives of promoting consumer protection, market integrity and competition. In our view, maintaining a strong and robust regulatory and supervisory system, and our commitment to achieving the highest international standards, go hand in hand with the UK's competitiveness as a global financial centre.

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We support open markets, with mechanisms to defer regulatory and supervisory oversight to other jurisdictions, so long as we are comfortable that their rules provide equivalent outcomes to the UK's and we have strong cooperation arrangements in place. Deference reduces costs and frictions for firms and minimises unnecessary market fragmentation, and is a longstanding commitment recognised at the G20. We remain committed to working with partners across the globe to shape international standards. Just last week, IOSCO published a report [7] on 'Good Practices on Processes for Deference', which sets out what authorities could consider when undertaking deference assessments of individual jurisdictions or individual firms. We contributed to that report and are supportive of that work.

Outside of international committees, we are providing technical advice and support to the Government as it looks at future trade opportunities. Yesterday, the Treasury issued a joint statement [8] with Switzerland on a shared ambition to work towards mutual recognition of each other's regulatory and supervisory regimes, taking an outcomes-based approach. The Chancellor also announced that the Treasury has assessed Swiss stock markets as equivalent, which holds out the prospect of reciprocal access to the Swiss and UK stock exchanges being facilitated after the transition period.

We are also continuing our programme of international engagement, for example, through the upcoming UK-Singapore Financial Dialogue, discussing future cooperation and recent trends and impacts on our economies, including our respective responses to Covid-19.

The impact of Covid-19 and other changes

As the impact of Covid-19 became manifest in global financial markets, we have worked intensely to maintain open and orderly markets, recognising the essential role they play in supporting businesses, governments and the broader economy. In doing so, we have coordinated with partners here in the UK, EU and globally. We have shared insights on market developments and coordinated responses, for example with the Financial Stability Board, IOSCO and ESMA. I have certainly valued our work together towards common goals.

Following the initial phase of the crisis, we are now looking at conduct and resilience of the markets in the medium and longer term, as well as broader trends that existed before the crisis, but which have become ever more important in the recovery.

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I will focus on a few key themes.

In terms of market resilience, we know that the global financial system as a whole is more resilient than it was 10 years ago. But we will naturally be reviewing what happened over the early phase of the pandemic, when the impacts of lockdown measures implemented across multiple jurisdictions were very clearly felt in markets.

In doing this, we need to focus on developing a complete picture of how all elements of the system – banks, non-banks, and market infrastructures – are interconnected, and how they function under extreme stress. Only then can we identify any potential vulnerabilities.

We need to be balanced and scrupulous in our analysis, and acknowledge the fundamental purpose of the system – that financial markets exist to allocate capital and to manage risk. Some already say that there may be vulnerabilities that need addressing in the non-bank sector, and if this proves to be the case then care should be taken that in attempting to take risk out of that sector, we do not simply transfer it to another part of the system.

Crucially, it is important that any possible change to existing frameworks do not undermine markets' ability to perform their essential functions. We must recognise that the non-bank sector will be critical in enabling recapitalisation to promote growth and recovery from the pandemic. So, the benefits of a vibrant market should be considered alongside the potential risks.

The Government announced [9] last week its plan to give the FCA enhanced powers to help manage and direct an orderly wind-down of critical benchmarks such as LIBOR, in particular with regard to 'tough legacy' contracts. We will be publishing statements of policy, setting out our intended approach to potential use of these powers, ahead of taking any action, and will seek the views of stakeholders here in the UK and internationally as we prepare those statements.

Firms' operational resilience has been tested in the crisis, and overall performed well – despite increased reliance on dispersed working. In the UK, we are consulting with the PRA [10] through to October 2020 on new requirements to strengthen operational resilience in financial services – with the aim of staying ahead of evolving risks, to ensure ongoing financial stability and market integrity.

The disruption caused by Covid-19 has demonstrated the value of technology in overcoming some of these challenges. Digital innovation may help address issues from the longer-term decline in the use of cash, increase the availability of mass market financial advice, and reduce the need for manual processes in businesses. We are committed to supporting innovation that works for all, including vulnerable consumers and smaller firms. We know that our regulatory framework needs to keep pace – focussing on outcomes, and being forward looking. To that end, our digital sandbox will be open for applications this summer.

Sustainable finance remains an area of key interest to investors. As the UK prepares to host COP26 and moves to a 'green recovery', the role of private finance is front and centre. The pandemic has also elevated social considerations such as supply chain sustainability, employee welfare and corporate culture. The FCA's focus is on well-functioning markets, including clear disclosure, and internationally we are co-leading the work on climate-related financial disclosures at an IOSCO Task Force.

We stand ready to work with you all, as well as fellow regulators and authorities – in the UK and abroad – to deliver a connected and robust financial system that will thrive in the new era

And as highlighted in our Business Plan [11], to ensure we are well positioned to tackle these and other challenges, we are working to continuously transform our own approach – for example through the use of data and analytics.

Conclusion

We are going through a period of tremendous change, and there remain many challenges to overcome. But we also have tremendous opportunities: the opportunity to maintain high standards in our regulated markets, delivering the right outcomes for consumers; to tackle the challenges of Brexit and Covid-19 in an agile way, and for the long term.

We stand ready to work with you all, as well as fellow regulators and authorities – in the UK and abroad – to deliver a connected and robust financial system that will thrive in the new era.

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