Future Regulatory Framework Review
Financial Services Strategy
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Financial Services Future Regulatory Framework Review: Proposals for Reform

The International Swaps and Derivatives Association (**ISDA**) welcomes the opportunity to respond to HM Treasury's consultation on the Future Regulatory Framework. Our response focusses on questions 10 and 11 as the questions most relevant to ISDA's focus on safe, efficient derivatives markets.

1. Executive summary

ISDA members welcome the proposal to return to a comprehensive FSMA model of financial services regulation. However, we would like to flag the following key comments for HM Treasury's attention:

- It will be critical that the regulators consider the interaction between different pieces of legislation and any cross-cutting impacts when repealing and remaking retained EU law, and either aim to repeal and remake interconnected legislation at the same time or else provide clear guidance on how firms should comply.
- It will also be important to give the industry sufficient time to digest any proposed new rules, build in appropriate transitional provisions and provide marked up versions of any amended legislation so that the industry can track the changes being made.
- In relation to the proposed Designated Activities Regime:
    - Regulation of activities should provide for consistent treatment of authorised and unauthorised firms, with divergent treatment only where justified;
    - Careful consideration should be given to the scope of the powers under the Designated Activities Regime, including its territorial scope and general principles regarding areas to be covered by the powers;

- Care also needs to be taken over any clarification of legacy EU terminology, as many terms are currently undefined or defined only through regulatory guidance. Any clarifications should be consulted on to ensure that the effect of any changes is fully understood;
- HM Treasury should ensure that the consultation process for rules made under the Designated Activities Regime reaches as wide a range of potentially interested persons as possible;
- HM Treasury should also consider whether any changes to the information gathering powers of the regulators are required in order for them to properly supervise unauthorised entities subject to rules under the Designated Activities Regime.

- Any activity-specific "have regards" should clarify the extent to which they apply in the same way to both the FCA and the PRA, or to activities carried on by authorised and unauthorised entities, as well as the extent to which other "have regards" of general FCA or PRA objectives or principles apply.

2. Responses

Question 10: Do you agree with the government's proposal to establish a new Designated Activities Regime to regulate certain activities outside the RAO?

Revoking retained EU law

ISDA members welcome the proposal to return to a comprehensive FSMA model of financial services regulation and agree that this approach should ensure consistency and development of coherent and user-friendly rulebooks.

We also welcome the intention to ensure that the repeal takes effect at the same time as the regulators' new rules come into force, to avoid any "gap" in regulation. However, it will also be important that the regulators consider the interaction between different pieces of legislation and either aim to repeal and remake interconnected pieces of legislation at the same time or otherwise build in clear guidance on how firms should comply with the combination of legacy EU law and new regulator rulebook text.

It will also be important to give the industry sufficient time to digest any proposed new rules (in order to identify any material differences or implementation challenges) as well as building in appropriate transitional provisions.

Designated Activities Regime

ISDA members also welcome the proposal to deal with certain activities outside of the RAO. As HM Treasury outlines in the consultation, it clearly doesn't make sense to try to identify activities subject to specific regulation in the same piece of legislation that defines the

regulatory perimeter for the purposes of the licensing regime. We also agree that bringing all the existing provisions into one place in a coherent framework makes a lot of sense and should ensure both that unauthorised firms subject to these obligations can look at a single framework to identify the rules that apply to them, and also that the regulators can develop a consistent approach to regulation of these activities (in some cases provisions of retained EU law that should be aligned in terms of scope and application are no longer as aligned as they should be as a result of being developed in parallel at different points in time).

However, it will be important to ensure that some key issues are addressed at the outset of this new time. In particular:

- **Consistency of treatment for authorised and unauthorised firms carrying on the same designated activity**: We understand that for activities where the regulators would need to make rules for both authorised and unauthorised firms, these rules would be contained in the same place and maintained in tandem (i.e., we would not have rules on OTC derivatives for authorised firms in one place in the FCA Handbook and rules for unauthorised firms in another place), to avoid the risk that we end up with divergence between the rules that apply to authorised firms and the parallel rules that apply to unauthorised firms.
- **Territorial scope of the powers**: Box 7.A in the consultation paper states that HMT would specify designated activities by Statutory Instrument (e.g., short selling, issuing securities). However, in many cases it may be necessary to do more than just specify the activity. For example, the territorial scope of the regulators' powers to regulate these activities should also be set out in the DAR (e.g., do these powers apply only to UK incorporated entities, to incoming branches of non-UK entities, to non-UK entities carrying on business with UK counterparties or to all non-UK entities carrying on the specified activity in relation to UK listed / traded instruments). At least where the DAR addresses activities currently covered by retained EU law, the territorial scope is not always consistent and in many cases is unclear, meaning that rather than having a single territorial scope for all activities covered by the DAR, there may be different territorial scopes depending on the activities being carried on.
- **General scope of the powers**: It would also be useful to understand whether the intention is that the regulators will have a general power to make any rules in relation to designated activities, or whether the DAR (or FSMA) will set out some general principles for what those rules should cover. For retained EU law we understand that the intention would be to remake the rules, adjusted as necessary to best suit the UK markets. However, for any future new use of the DAR, it will be critical to define what the scope of the regulators' power is to make rules.
- **Clarification of legacy EU terminology**: Where the regulators remake retained EU law as rules, it will also be necessary to give a clear meaning to terms that may not currently be clear or that are not commonly used in UK regulation. This will require

careful consideration to make sure that the regulators are not making fundamental changes through their rules (or that if they are, these changes are fully understood).

- **Need for a change to the current consultation process**: It may be necessary to review the current process for consultation undertaken by the regulators, to ensure that any consultations will be easily accessible by unregulated UK entities as well as any non-UK entities that may be impacted. While all consultations are already publicly available, so should be accessible by any interested person, unregulated UK entities and non-UK entities may not appreciate that UK regulation could apply directly to them and so may not engage with consultation papers. It may be necessary to have a process to flag relevant consultation papers to the attention of UK and non-UK entities that may not otherwise review and respond to them.
- **Need for a change to the current information gathering powers**: It may also be necessary to consider whether the current information gathering powers of the regulators are appropriate for use in connection with unregulated UK or non-UK entities. In particular, the regulators will need to be sensitive to the restrictions on transfers of information that unregulated entities / non-UK entities may be subject to. While this issue already arises in connection with authorised UK entities, those entities have chosen to obtain UK authorisation and understand the balance between the need to disclose information to the UK regulators and the need to comply with any restrictions that may apply in other jurisdictions (and may in fact benefit from exemptions where they are required to disclose information to regulators). However, unauthorised entities may also be subject to similar restrictions on their ability to transfer or disclose information but may not be able to rely on exemptions for disclosure to regulators, as the FCA / PRA would not be their regulator. If these entities may become subject to information gathering powers simply because they are trading with UK entities or in UK listed or traded instruments, this could end up presenting a barrier to cross-border business.

Question 11: Do you agree with the government's proposal for HM Treasury to have the ability to apply "have regards" and to place obligations on the regulators to make rules in relation to specific areas of regulation?

Bringing FMIs covered by retained EU law into FSMA regulation

We agree that the DAR will not be an appropriate approach to all areas of retained EU law that currently sit outside the core FSMA authorisation framework, including regulation of entities that are subject to specific regimes (e.g., CCPs, CSDs and TRs) but which are not required to obtain authorisation under FSMA and the RAO.

We comment further on this proposal in our response to HM Treasury's consultation paper on the Future Regulatory Framework Review for CCPs and CSDs.

Activity-specific have regards and obligations

We agree that where rules currently contained in retained EU law were specifically drafted to address certain public policy points which are still relevant, regulators should continue to have those public policy priorities in mind when updating those rules in future.

Where the government sets specific "have regards" for the regulators when making rules in relation to activities covered by the DAR, it will be important to clarify the extent to which any other objectives, principles or have regards also apply to rule-making in relation to those activities. For example, if the government sets "have regards" for the FCA when it is making rules in relation to uncleared derivatives, would the same "have regards" also apply to the PRA when it is making rules in relation to uncleared derivatives? Would the same "have regards" apply when the FCA is making rules in relation to similar activities (e.g., securities financing transactions)? Would other "have regards" or general FCA objectives and principles also apply?

We would also caution that the proposed power for the government to place obligations on the regulators to make rules in relation to specific areas of regulation should be subject to appropriate safeguards. For instance, its use should be restricted to areas that are already subject to requirements in statute. This would prevent it becoming a substitute for primary legislation.

While we appreciate that the government's proposed power to place obligations on the regulators to make rules in relation to specific areas of regulation is not intended to seek to influence what those rules should be, we are unclear on what the purpose of this power would be or why it would be appropriate for the government to require the FCA (e.g.) to make rules relating to the reporting of financial transactions if the FCA did not consider that this was necessary. If the intention is that the regulators should be required to have regard to G20 commitments and the guidance published by other international standard setting bodies when making their rules, we consider that this could be addressed without giving the government the power to require the regulators to make rules in a specific area. The example of an existing use of this type of power given by HM Treasury in the consultation paper is an example of an obligation imposed through primary legislation (HM Treasury refers to section 143C of FSMA, which requires the FCA to make rules applying to FCA investment firms, that impose certain types of prudential requirements). However, the consultation paper indicates that the government intends to take a more general power. If HM Treasury intends to take a power that is not clearly defined in primary legislation (i.e., a general power to require the regulators to make rules in relation to specific areas of regulation), it will be necessary to have clear published parameters around how this power may be exercised.

Revocation and amending retained EU law for purposes other than regulator rulemaking

In principle we support the process outlined in paragraphs 7.46 – 7.54 of the consultation paper, in particular the close coordination and sequencing between HM Treasury and the regulators.

In practice many of the changes will be highly technical and involve numerous legal drafting changes with potential for unintended consequences and cross-overs between dossiers. We would therefore urge consideration of joint consultations, and for the structure to set out the changes to relevant legislation side-by-side with the corresponding new handbook rules, with explanations of any changes being proposed. Accompanying explanatory memoranda should be published alongside draft legislation, setting out in plain English the policy intent of the drafting.

Further, the way EU law has been onshored means there are no consolidated versions of the rules available, which makes them incredibly difficult for market participants to read. As such, HM Treasury's proposals for changes to legislation should include (as an annex) full marked up text, in the way the FCA typically present clear mark-ups to their handbook text. This would improve accessibility, make reviews of proposed changes much more focused and efficient, enhance clarity and certainty around what is proposed, enable industry to better focus its energy, and could streamline the overall change process and compress timelines.

We thank you for taking the time to consider our views on this issue. If you have questions on any of the issues addressed in this letter, we are happy to discuss them with you at your convenience.

Yours faithfully,

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Annex

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 960 member institutions from 77 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter @ISDA.