Consultation response

Financial Services Future Regulatory Framework Review: Phase II Consultation

February 2021

Introduction

The Law Society of Scotland is the professional body for over 12,000 Scottish solicitors.

We are a regulator that sets and enforces standards for the solicitor profession which helps people in need and supports business in Scotland, the UK and overseas. We support solicitors and drive change to ensure Scotland has a strong, successful and diverse legal profession. We represent our members and wider society when speaking out on human rights and the rule of law. We also seek to influence changes to legislation and the operation of our justice system as part of our work towards a fairer and more just society.

Our Banking, Company and Insolvency Law Committee welcomes the opportunity to respond to the UK Government’s Financial Services Future Regulatory Framework Review Phase II Consultation.[[1]](#footnote-2) We have the following comments to put forward for consideration.

Response to questions

**1. How do you view the operation of the FSMA model over the last 20 years? Do you agree that the model works well and provides a reliable approach which can be adapted to the UK’s position outside of the EU?**

The FMSA model in conjunction with the Regulated Activities Order and consolidated (single source) rulebooks have been a welcome development. We do believe FSMA provides a reliable (and well tested) approach in conjunction with regulator rulebooks and has the benefit of certainty, continuity in a period of fairly dramatic change and flexibility as a framework with minimal disruption for market participants.

It is noted that the EU rules are legislative rather than rule-book based and this was clearly required due to its multijurisdictional application and to best achieve consistency. On-shored EU rules do not need to be enshrined in legislation for application in the UK (at least as far as the UK is concerned).

That does however raise the question of whether moving the on-shored EU rules from a legislative footing to being rule book based would affect any equivalency decision by the EU. It should be noted that in light of the uncertainty around the equivalency decision (both in whether it will be granted but also that it can be removed on 30 days' notice) most financial services firms have adopted the approach of being fully regulated in each EU jurisdiction in which they operate. This approach is clearly anticipated in the discussions between EU and UK with the Trade and Co-operation Agreement (TCA) making express reference to UK firms authorised in one EU member state not being automatically passported to operate in another. The TCA is more trade focused and services-lite. Financial services as a subset of services has even fewer provisions. A number of the services sections expressly exclude their application to financial services. There is an expectation that a Memorandum of Understanding constituting a framework of co-operation in financial services will be entered into between the EU and UK in March. How far this document will go in addressing concerns is not clear. Multiple authorisations and compliance with different regulatory requirements in multiple jurisdictions is a huge administrative burden and one which one would be forgiven in concluding can only be undertaken by entities of sufficiently large scale. This has the knock effect of limiting market access to larger firms and excluding smaller market participants.

The UK rule books have largely been updated to incorporate specific rules emanating from and based upon EU financial services legislation. These of course have direct application in the UK now through the on-shoring legislation and subordinate legislation. The fact is however that considerable work has already been done in ensuring the rule books are EU rule compliant.

On balance the UK financial services industry is likely to prefer a single approach to be adopted for new UK rules and EU on-shored financial services regulation. This is preferable to the EU on-shored regulations continuing to follow the historic approach of being legislation based rather than contained within the regulators’ handbooks. The EU on-shored regulations frankly cover such a diverse range of aspects of financial services regulation that attempting to keep both approaches would become increasingly unmanageable.

**2. What is your view of the proposed post-EU framework blueprint for adapting the FSMA model? In particular:   
•What are your views on the proposed division of responsibilities between Parliament, HM Treasury and the financial services regulators?  
•What is your view of the proposal for high-level policy framework legislation for government and Parliament to set the overall policy approach in key areas of regulation?  
•Do you have views on how the regulators should be obliged to explain how they have had regard to activity-specific regulatory principles when making policy or rule proposals?**

The proposed post-EU framework blueprint is broadly fine and we agree that it is appropriate that there is a policy direction from legislators and detailed regulatory provisions can be set by regulators with appropriate knowledge and expertise guided by the policy with input from market participants.  The process should in our view be structured in a way which prevents and safeguards against policy resulting in market instability or uncertainty.  The consultation sets out a number of checks and balances but concerns would arise over the risk of a short-term politically-motivated approach to policy setting, which could have a detrimental effect on the market in the medium or long term.

The approach requiring regulators to be called to account and held to account is in keeping with regulators considerations when rule setting and implementation and provides a more formalised process. It should not, if appropriately implemented, result in unnecessary administrative burden and should not affect responsiveness to change.

**3. Do you have views on whether and how the existing general regulatory principles in FSMA should be updated?**

On balance we feel it is better during this period of significant regulatory transition to leave the regulatory principles as they stand at present. A review can however be implemented at a later stage. This will allow market participants time to deal with other more pressing changes anticipated in the post-Brexit regulatory environment. The principles provide a strong structure to current regulation.

**4. Do you have views on whether the existing statutory objectives for the regulators should be changed or added to? What do you see as the benefits and risks of changing the existing objectives? How would changing the objectives compare with the proposal for new activity-specific regulatory principles?**

One concern when following activity specific regulatory objectives would be having potential divergence within the UK across business streams and unnecessary 'small' differences between regulated activities, increasing administrative burden on industry. This is of particular concern for businesses operating multiple regulated activities.  We would favour a unified core set of objectives which apply to all activities with activity specific 'add-ons'.

**5. Do you think there are alternative models that the government should consider? Are there international examples of alternative models that should be examined?**

No comment.

**6. Do you think the focus for review and adaptation of key accountability, scrutiny and public engagement mechanisms for the regulators, as set out in the consultation, is the right one? Are there other issues that should be reviewed?**

We are broadly in agreement to with what is proposed.  We have already mentioned above the concern industry would have over short-term politically-motivated objectives having an impact on fundamental requirements of the industry such as maintaining stability. We consider that specific checks and balances are required to address this concern.

**7. How do you think the role of Parliament in scrutinising financial services policy and regulation might be adapted?**

No comment.

**8. What are your views on how the policy work of HM Treasury and the regulators should be coordinated, particularly in the early stages of policy making?**

We agree with an approach that requires early co-ordination between HMT and the regulators.  We also feel it would be appropriate to have a clear line between policy and regulations.

**9. Do you think there are ways of further improving the regulators’ policy-making processes, and in particular, ensuring that stakeholders are sufficiently involved in those processes?**

We generally see a very active consultation process by UK regulators where views are sought regarding both anticipated policy and rules changes.  However, post rule-change reviews to assess implementation could be formalised: this could help to ensure that objectives of the respective rule changes are achieved and that any unforeseen consequences can be rectified.

**For further information, please contact:**

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1. <https://www.gov.uk/government/consultations/future-regulatory-framework-frf-review-consultation> [↑](#footnote-ref-2)