

The Edinburgh Reforms – post-Brexit financial (de)regulation

Tailored regulatory reform at its best or a race to the bottom? **John Verwey** and **Sulaiman Malik** provide an overview of the Edinburgh Reforms and their potential impact on the UK's status as a global financial hub.

On 9 December 2022, the United Kingdom's Chancellor of the Exchequer announced an expansive set of reforms to the jurisdiction's financial regulatory regime – labelled the 'Edinburgh Reforms'.

Following the UK's exit from the European Union, much of the EU financial regulatory regime was transposed and 'onshored' into the UK's statute books. In the UK Government's own words the Edinburgh Reforms "*set out plans to repeal, and replace, hundreds of pages of burdensome EU retained laws governing financial services*". The vision is for a more agile and targeted UK regulatory framework, that drives growth and competitiveness.



UK Chancellor Jeremy Hunt

Key proposals

The proposals in the Edinburgh Reforms are wide-ranging – touching on nearly every aspect of the financial services sector. Some of the key proposals include:

Implementing the Financial Services and Markets Bill

On 20 July 2022, the Financial Services and Markets Bill was introduced to Parliament. Although this is still going through the legislative process, the Bill provides a broad mandate to the Government and regulators to shape the future of UK financial regulation, including reworking inherited EU rules. A policy statement published as part of the Edinburgh Reforms now sets out what this process will look like. [1]

The process of reviewing/repealing retained EU law will occur in tranches. 'Tranche 1' is already underway and includes the Wholesale Markets Review [2], as well as reviews of the Prospectus Regulation, Securitisation Regulation and the Solvency II Directive. 'Tranche 2' will include rules such as the Packaged Retail and Insurance-based Investment Products Regulation (PRIIPs Regulation), Short Selling Regulation, Taxonomy Regulation and Capital Requirements Regulation and Directive.

The Government expects to make "*significant progress*" on Tranches 1 and 2 by the end of 2023. The remaining rules (the full list is set out in the policy statement) will be prioritised as needed in Tranche 3. The Government has also published illustrative draft Statutory Instruments to give an indication of how the powers under the Bill will be used. [3] These relate to the Prospectus Regulation, Securitisation Regulation, along with Payment Services and E-Money Regulations.

FCA/PRA remit

The Government has published new remit letters for the Financial Conduct Authority [4] and Prudential Regulation Authority [5] with clear, targeted recommendations on growth and international competitiveness.

Ring-fencing reforms

In February 2021, HM Treasury appointed Keith Skeoch to undertake a statutory review of the ring-fencing regime and propriety trading. The 'Skeoch Report' was subsequently published in March 2022, which concluded that the UK's ring-fencing regime is worth keeping, but may gradually be superseded by the recovery and resolution regime. [6]

As part of the Edinburgh Reforms, the Government announced that it intends to publish a Call for Evidence in Q1 2023, to review the practicalities of aligning the ring-fencing and resolution regimes. In addition, the Government will consult in mid-2023 on reforms to improve the functionality of the ring-fencing regime, in line with the recommendations from the Skeoch Report such as: [7]

- taking banking groups without major investment banking operations out of the regime;
- reviewing and potentially expanding activities that ring-fenced banks can carry out; and
- increasing the deposit threshold (above which the ring-fencing regime applies) from £25 billion to £35bn.

A new UK retail disclosure framework

The Government plans to repeal the PRIIPS Regulation in favour of a new UK retail disclosure framework. The Government has published a consultation paper, noting that the current regime is not fit for purpose due to the “*misleading information that it requires be provided to investors and the unnecessary burden that it places on firms*”. [8] This consultation paper closes on 3 March 2023.

A new UK short selling regime

The Government plans to repeal the onshored Short Selling Regulation and has published a Call for Evidence as part of its review. [9] The replacement regulation aims to be tailored to UK markets and bolster its competitiveness. This Call for Evidence closes on 5 March 2023.

SMCR review

The Government has announced it will review the Senior Managers and Certification Regime in Q1 2023, beginning with a Call for Evidence on the legislative framework. The FCA and PRA will also conduct their own reviews.

ESG developments

The Government has confirmed that it will publish an updated Green Finance Strategy in early 2023 and will publish a consultation in Q1 2023 on bringing environmental, social and governance ratings providers into the regulatory perimeter.

This fits within the Government’s wider ESG strategy. In October 2022, the FCA published its consultation paper (CP22/20) on Sustainability Disclosure Requirements (SDR) and investment labels, closing on 25 January 2023. [10] Earlier that month, the UK’s Green Technical Advisory Group published its first report on the development of a UK Green Taxonomy. [11]

Once finalised, the SDR and UK Green Taxonomy will represent the UK’s efforts to match the EU’s SFDR and Taxonomy Regulation.

Other announcements

Other announcements include:

- consulting on the reform to the VAT treatment of fund management; [12]
- overhauling the UK’s regulation of prospectuses;
- reforming the Securitisation Regulation;
- intending to repeal EU legislation on the European Long-Term Investment Fund in favour of the new UK Long-Term Asset Fund;
- establishing an Accelerated Settlement Taskforce; [13]
- committing to establish the independent Investment Research Review;
- publishing a response to the consultation on expanding the Investment Manager Exemption to include cryptoassets; [14] and
- in the coming weeks, consulting on a UK retail central bank digital currency alongside the Bank of England.

Supercharging the UK as a financial hub

For those tracking the Government’s messaging, these reforms should hardly come as a surprise. In the run-up to the Brexit vote itself, much was made of the ability to cut EU ‘red tape’ – including within the realm of financial services.

Brexit has had an undeniable impact on the attractiveness of the UK as a financial hub. In the immediate aftermath of the referendum, many financial institutions began shifting certain operations to Ireland and/or continental Europe. According to a report published by EY, as of March 2022, 7,000 financial services staff and £1.3 trillion of assets have been transferred to the EU following Brexit. [15]

The Edinburgh Reforms are part of the Government’s plan to re-boost the attractiveness of the UK and the City of London. Such a notion is not that farfetched. Indeed, the plans are not dissimilar in concept to Margaret Thatcher’s ‘Big Bang’ in 1986 – measures that strengthened London’s position as a global financial hub through de-regulation.

The Government is also mindful that it is not only competing with Europe. Policy decisions such as scrapping bankers’ bonus caps have survived the turnover at Number 9 Downing Street. Such caps were never introduced in competing financial hubs such as New York, and all form part of the plan to elevate the UK beyond the perceived ceiling placed on it by the EU.

In the aftermath of the Brexit referendum, much discussion was had about whether the UK would still push for equivalent regulation to the EU. Optimists even considered whether the UK could maintain its access to the EU marketing passport. The Edinburgh

Reforms represent the Government putting this conversation to bed – why settle for equivalence when a more flexible and tailored regime is possible.

The risk of de-regulation

Legitimate concerns can be raised about this so-called ‘Big Bang 2.0’. Much of the regulation being re-worked was implemented following the Global Financial Crisis. With the Bank of England’s latest Monetary Policy Report stating that the UK is “*expected to be in recession for a prolonged period*”, it seems a peculiar time to dial-back a range of post-crisis safeguarding measures (or at least set out plans to do so). [16] Critics already view the reforms as a “race to the bottom”.

Andrew Bailey, the Governor of the Bank of England, has himself said that he would caution “*the notion we’re past the financial crisis, and we therefore don’t need the regulations that we had post the financial crisis*”. It bears emphasising that this is the view of someone the Government will need to work very closely with to implement the Edinburgh Reforms, not a commentator on the periphery.

One could also argue that the Government is trying to fix a problem that did not exist previously – there would not have been such a shift away from the UK and the City of London had it not been for Brexit.

Watch this space

Ultimately, with the UK having left the EU, the UK Government’s policy should be seeking to take advantage of the opportunities that arise from this. The intention behind the proposals is admirable – to make the UK’s financial services rules more fit for purpose and, in doing so, break away from the legacy of the EU regulatory regime. However, like all financial regulation, the devil will be in the detail. Many of the proposals are either currently or will soon be out for consultation, and it remains difficult to opine definitively on rules that are not yet final. How successful the Edinburgh Reforms will be in achieving their desired goals remains to be seen.

Notes

[1] Policy paper: Building a smarter financial services framework for the UK, published on 9 December 2022, www.gov.uk/government/publications/building-a-smarter-financial-services-framework-for-the-uk.

[2] Wholesale Markets Review: Consultation Response, published on 1 March 2022, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1057897/Wholesale_Markets_Review_Consultation_Response.pdf.

[3] Statutory instruments: Building a smarter financial services framework for the UK, published on 9 December 2022, www.gov.uk/government/publications/building-a-smarter-financial-services-framework-for-the-uk.

[4] FCA remit letter, ‘Recommendations for the Financial Conduct Authority’, published on 9 December 2022, www.gov.uk/government/publications/recommendations-for-the-financial-conduct-authority-december-2022.

[5] PRA remit letter, ‘Recommendations for the Prudential Regulation Committee’, published on 9 December 2022, www.gov.uk/government/publications/recommendations-for-the-prudential-regulation-committee-december-2022.

[6] Skeoch Report, Independent Panel on Ring-fencing and Proprietary Trading – Final Report, published on 15 March 2022, www.gov.uk/government/publications/independent-panel-on-ring-fencing-and-proprietary-trading-final-report.

[7] Policy paper: Ring-fencing reforms, published on 9 December 2022, www.gov.uk/government/publications/ring-fencing-reforms.

[8] Consultation paper: PRIIPs and UK Retail Disclosure, published on 9 December 2022, www.gov.uk/government/consultations/priips-and-uk-retail-disclosure.

[9] Call for Evidence: UK Short Selling Regulation, published on 9 December 2022, www.gov.uk/government/consultations/short-selling-regulation-call-for-evidence.

[10] Consultation paper: Sustainability Disclosure Requirements (SDR) and investment labels (CP22/20), published on 25 October 2022, www.fca.org.uk/publication/consultation/cp22-20.pdf.

[11] GTAG: Advice on the development of a UK Green Taxonomy, published on 1 October 2022, www.greenfinanceinstitute.co.uk/wp-content/uploads/2022/10/GTAG-Advice-on-the-development-of-a-UK-Green-Taxonomy.pdf.

[12] Consultation paper: VAT treatment of fund management, published on 9 December 2022, www.gov.uk/government/consultations/vat-treatment-of-fund-management-consultation.

[13] Policy paper: Accelerated Settlement Taskforce, published on 9 December 2022, www.gov.uk/government/publications/accelerated-settlement-taskforce.

[14] Consultation outcome: Expanding the Investment Transactions List for the Investment Management Exemption and other fund tax regimes, published on 9 December 2022, www.gov.uk/government/consultations/expanding-the-investment-transactions-list-for-the-investment-management-exemption-and-other-fund-tax-regimes.

[15] EY Financial Services Brexit Tracker: Movement within UK financial services sector stabilises five years on from Article 50 trigger, published on 29 March 2022, www.ey.com/en_uk/news/2022/03/ey-financial-services-brexit-tracker-movement-within-uk-financial-services-sector-stabilises-five-years-on-from-article-50-trigger.

[16] Monetary Policy Report – November 2022, published on 3 November 2022, www.bankofengland.co.uk/monetary-policy-report/2022/november-2022.

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