EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2000 (EXEMPTION) (AMENDMENT No 2) ORDER 2011

2011 No. 2716

1. This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This Order brings Northern Irish credit unions under the regulatory regime contained in the Financial Services and Markets Act 2000. Credit unions carry on the regulated activity of accepting deposits so, without the exemption, must be authorised and regulated by the Financial Services Authority in the conduct of their business and are subject to the provisions of that Act. The purpose of the instrument is therefore to effect a transfer of the regulatory functions of the Department for Enterprise, Trade and Investment in Northern Ireland (DETI) in respect of Northern Ireland credit unions to the Financial Services Authority.

2.2 Once authorised by the Financial Services Authority (the FSA), depositors with Northern Irish credit unions will have access to the Financial Services Compensation Scheme in the event of a default, and the Financial Ombudsman's Service.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Context

4.1 The Order revokes the exemption for credit unions registered in Northern Ireland from the regulatory requirements of the Financial Services and Markets Act 2000 (the 2000 Act). The exemption is in paragraph 24A of the Financial Services and Markets Act 2000 (Exemption) Order 2001. Once revoked, credit unions in Northern Ireland will be required to comply with the 2000 Act and the FSA's rules when they accept deposits or conduct other financial services which are regulated activities.

4.2 Credit unions in Great Britain have been subject to the regulatory regime in the Financial Services and Markets Act 2000 since 2nd July 2002.

4.3 This Order follows the affirmative procedure. If made, HM Treasury proposes to make and lay four further instruments to complete the effective transfer of DETI's regulatory and financial crime supervisory functions to the FSA. These instruments are:-

- The Financial Services and Markets Act 2000 (Permissions and Applications) (Northern Ireland Credit Unions) Order 2011: this Order will contain grandfathering provisions for credit unions and gives pre-commencement powers to the FSA.

- The Financial Services and Markets Act 2000 (Consequential and Transitional Provisions) (Northern Ireland Credit Unions) Order 2011: this Order will make amendments to the Credit Unions (Northern Ireland) Order 1985, and to secondary legislation made under it, to amend DETI's powers and make it consistent with regulation under the 2000 Act.

- The Money Laundering (Amendment) Regulations 2011: these Regulations will transfer DETI's supervisory responsibilities under the Money Laundering Regulations 2007 for Northern Ireland credit unions to the FSA.

- The Terrorist Asset-Freezing etc. Act 2010 (Commencement) Order 2011: this Order will transfer DETI's supervisory responsibilities under Schedule 7 to the Counter-Terrorism Act 2008 for Northern Ireland credit unions to the FSA.

4.4 These instruments will not effect a transfer of DETI's function as the registrar for credit unions in Northern Ireland. That function is a transferred matter under the Northern Ireland Act 1998.

4.5 The regulatory position of all UK depositors, including Northern Ireland credit unions, is currently being reviewed by the Government in the context of its reform of the financial services sector. These substantial reforms will require primary legislation which it is expected will be introduced into Parliament in 2012 and, as a result of which, the regulation of all UK credit unions would change from 2013.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom but only relates to credit unions registered in Northern Ireland.

6. European Convention on Human Rights

The Financial Secretary to the Treasury has made the following statement regarding Human Rights:

In my view the provisions of the Financial Services and Markets Act 2000 (Exemption) (Amendment No. 2) Order 2011 are compatible with the Convention rights.

7. Policy background

7.1 Approximately 177 credit unions are registered with the DETI in Northern Ireland. Although relatively few in number, they serve over 400,000 members, half the adult population of Northern Ireland. These are the only sector of deposit-taker operating in the United Kingdom which are not authorised and regulated by the FSA, but, instead, by the DETI. This has had several consequences. NI credit unions and their members have no access to the Financial Service Compensation Scheme (the FSCS), which currently provides compensation of up to £85,000 per individual in the event of default. Their unauthorised status has also limited the products and services which they may offer, such as current accounts, ISAs, insurance and the transfer of securities. This places them at a significant disadvantage when their position is compared with both credit unions in Great Britain and credit unions in the Republic of Ireland. Their members are also unable to access the Financial Ombudsman Service.

7.2 The policy is to remedy the anomalous position of Northern Irish credit unions by requiring them to be authorised and regulated by the FSA (and, where appropriate, the FSA may grant permissions to offer a wider range of products and services), provide their members with access to the FSCS in the event of a default, provide access to the Ombudsman Service.

7.3 The Committee for Enterprise, Trade and Investment in the Northern Ireland Assembly commissioned an Inquiry into the Role and Potential of Credit Unions in Northern Ireland in March 2008. It examined the role of credit unions within the communities they serve, identified barriers preventing them from offering a wider range of services, and considered how the potential could be unlocked to permit them to expand their range of service and be supported in so doing. One of the Committee's main legislative recommendations was that the regulation of credit unions should move from the DETI to the Financial Services Authority to enable them to have access to a universal compensation scheme and allow them to offer a wider range of services.

7.4 On 9th February 2010 the Treasury Select Committee reported on the failure of the Presbyterian Mutual Society. It reported:

> "We support the principle of FSA regulation of credit unions in Northern Ireland. Credit unions are prominent in the society of Northern Ireland and it would benefit their many members if they were able to offer some of the services provided by their counterparts in Great Britain. Moreover, there is a regulatory gap which needs to be filled. Allowing credit unions in Northern Ireland to be regulated by the FSA would fill that gap."

7.5 In March 2010 the previous Government committed to effect this change and, with the DETI, published a Joint Consultation on how that might be achieved in Proposals for Regulatory Reform of Credit Unions in Northern Ireland.

7.6 In October 2010 this Government responded to the Treasury Select Committee's Sixth Report on the failure of the Presbyterian Mutual Society. In relation to credit unions in Northern Ireland, this Government responded that it agreed with the Committee's recommendation and, together with the FSA and the DETI, aims to bring about the transfer of regulation of Northern Ireland credit unions to the FSA at the earliest opportunity.

8. Consultation outcome

8.1 The Summary of Responses to the March 2010 Consultation document will be published shortly. This will appear on the HM Treasury website.

9. Guidance

9.1 The FSA is consulting with the sector on the details of how NI credit unions will be regulated by it under its rules. The FSA and the DETI are also working closely with trade associations to provide guidance to the sector on the transition.

10. Impact

10.1 The impact on credit unions is £1.657 million over the next 10 years. The impact on business (other than credit unions), charities or voluntary bodies is negligible.

10.2 The impact on the public sector is likely to be negligible. The DETI will be relieved on its regulatory functions in relation to Northern Irish credit unions and the FSA will take on responsibility for them. The FSA already performs these functions in relation to GB credit unions.

10.3 An Impact Assessment is attached to this memorandum and will be published alongside the Explanatory Memorandum on www.legislation.gov.uk. This comprehensively sets out the costs and benefits associated with this policy.

11. Regulating small business

11.1 The legislation applies to small credit unions.

11.2 To minimise the impact of the requirements on credit unions employing up to 20 people, Northern Irish credit unions will not all be required to make fresh applications for permission to accept deposits under the 2000 Act. Instead they will all be deemed to hold permissions to accept deposits from 31st March 2012 but the FSA will have power to require individual credit unions (or a class of credit unions) to reapply for permission if it considers that the circumstances merit it. Further, individuals performing certain functions in credit unions will be deemed, from 31st March 2012, to be persons approved by the FSA under the 2000 Act to perform those functions. The FSA will also have a power to issue a direction requiring a named credit union (or class of credit unions) to reapply for approved person status for individuals.

12. Monitoring & review

12.1 The regulation of financial services, and deposit-takers in particular, is currently the subject of reform which has been the subject of an initial consultation by the Government. In due course the Government will consult on what these reforms will mean for credit unions.

13. Contact

Ben Crosland at the Mutuals Team, HM Treasury, 1 Horse Guard's Road, London SW1A 2HQ Tel: 020 7270 6620 or email: ben.crosland@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.