

EXPLANATORY MEMORANDUM TO
THE FINANCIAL SERVICES AND MARKETS ACT 2000 (DISAPPLICATION OR
MODIFICATION OF FINANCIAL REGULATOR RULES IN INDIVIDUAL CASES)
REGULATIONS 2024

2024 No. [XXXX]

1. Introduction

- 1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of His Majesty.

2. Declaration

- 2.1 The Economic Secretary to the Treasury (Bim Afolami MP) confirms that this Explanatory Memorandum meets the required standard.
- 2.2 Catherine McCloskey, Deputy Director for Financial Services Strategy, at HM Treasury confirms that this Explanatory Memorandum meets the required standard.

3. Contact

- 3.1 Lee O'Rourke at HM Treasury Telephone: 07825 530 010 or email: lee.orourke@hmtreasury.gov.uk can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

- 4.1 The Financial Services and Markets Act 2023 ("FSMA 2023") introduced a number of new legislative powers which work together as a set of tools as the government repeals assimilated law (known as "retained EU law" until the end of 2023) to deliver a Smarter Regulatory Framework (SRF) for financial services. Assimilated law will be replaced by rules set by the financial services regulators under a framework set by the government and Parliament.
- 4.2 One of the tools introduced by FSMA 2023 is new section 138BA of the Financial Services and Markets Act 2000 ("FSMA") which provides a power for HM Treasury to make regulations to grant the financial services regulators the ability to disapply or modify rules made by the regulators under FSMA.
- 4.3 This instrument, which is made under section 138BA of FSMA, grants the Prudential Regulation Authority (PRA) the ability to disapply or modify the application of any of its rules made under FSMA, where appropriate, to take into account the circumstances and business models of individual firms. The ability to flex rules in this way contributes to one of the government's key objectives for the SRF: to deliver an agile regulatory regime which can respond quickly to take account of changing market conditions, address emerging risks and facilitate innovation.

Where does the legislation extend to, and apply?

- 4.4 The extent of this instrument (that is, the jurisdictions which the instrument forms part of the law of) is England and Wales, Scotland and Northern Ireland.
- 4.5 The territorial application of this instrument (that is, where the instrument produces a practical effect) is England and Wales, Scotland and Northern Ireland.

5. Policy Context

What is being done and why?

- 5.1 The Smarter Regulatory Framework delivers the FSMA model of regulation for areas currently regulated under assimilated law. Under the FSMA model of regulation, the financial services regulators generally take responsibility for setting the direct regulatory requirements that apply to financial services firms, acting within a framework set by government and Parliament. One of the advantages of the FSMA model is that the regulators are well placed to update and flex requirements to ensure that regulation is responsive, including the flexing of rules to take account of the particular circumstances and business model of an individual firm.
- 5.2 Section 138BA of FSMA is a new tool which can be used to provide the regulators with flexibility when applying regulator rules to individual firms. Where HM Treasury exercise this power for rules made by the regulators under FSMA, a firm may apply to the relevant regulator for permission to disapply those rules or modify their application. Or the regulator may itself disapply or modify those rules for an individual firm if the firm consents.
- 5.3 This instrument, which is made under section 138BA of FSMA, grants the PRA flexibility to disapply or modify any rule that the PRA makes under FSMA. It also introduces certain procedural requirements that must be followed in relation to PRA decisions on disapplying or modifying PRA rules. The PRA must issue decision notices to applicant firms, which either grant a permission to disapply or modify specified rules or which explain any decision to refuse such a permission or to impose conditions on the permission. It also requires the PRA to issue a decision notice to applicant firms explaining any decision to vary or revoke an existing permission. Where the PRA gives permission for a rule to be disapplied or modified, it must publish a decision notice so that there is transparency about which firms are subject to disapplied or modified rules. Affected firms may also challenge a decision made by the PRA by referring the decision to the Upper Tribunal (Tax and Chancery Chamber), which is a part of the Courts and Tribunals Service responsible for hearing appeals against decisions made by various public sector bodies, including the PRA.

What was the previous policy, how is this different?

- 5.4 The ability to flex the application of regulator rules for individual firms is a well-established feature of the FSMA framework. However, the existing tool for the flexing of regulator rules – section 138A of FSMA – does not, by itself, provide sufficient flexibility for a truly agile regulatory regime. Section 138A requires the relevant regulator to have determined that the rules to be disapplied or modified are “unduly burdensome”, or “would not achieve the purpose for which the rules were made”, before giving a firm permission to disapply or modify those rules. This requirement does not always allow for rules to be flexed, even where appropriate disapplication or modification of rules would provide a better regulatory outcome.

- 5.5 Section 138BA of FSMA therefore provides an additional tool to ensure the appropriate level of flexibility for different areas of regulation. With the new tool for flexing regulator rules, once HM Treasury have specified that certain rules can be disapplied or modified under section 138BA, the relevant regulator will be less constrained as to how those rules can be flexed. This will make it easier for regulator rules to be tailored in ways which can better reflect the different business models and circumstances of individual firms as appropriate.
- 5.6 This instrument will enable the PRA to disapply or modify any of its rules made under FSMA (with the exception of conduct rules and PRA rules relating to threshold conditions, which are excluded under section 138BA(3)), providing flexibility in relation to PRA-regulated firms. The ability to tailor regulation to individual firm circumstances is particularly important for firms regulated by the PRA. PRA-regulated banks, investment firms and insurers are large and complex entities with varied and specialised business models, for which a highly responsive and tailored regulatory approach is required. Exercising the section 138BA power in this way, covering all PRA rules made under FSMA, will maximise the ability of the PRA to tailor the application of its rules in response to requests from, or with the consent of, individual firms.

6. Legislative and Legal Context

How has the law changed?

- 6.1 In addition to the provision at 138A of FSMA, firms will now be able to apply to have PRA rules disapplied or modified under section 138BA of FSMA, providing broader flexibility when considering requests for the disapplication or modification of regulator rules.

Why was this approach taken to change the law?

- 6.2 The existing mechanism for flexing the application of rules made by the financial services regulators, under which individual firms can apply to the relevant regulator for certain rules to be disapplied or modified, is a well-established, understood and supported feature of the UK's regulatory framework. This overall approach was therefore preserved in the design of new section 138BA, while at the same time addressing the constraint on the degree of flexibility that results from the operation of the conditions set out in section 138A of FSMA, as explained above. This instrument applies that well-established approach to all PRA rules made under FSMA, ensuring the PRA will have flexibility in deciding whether and how it will grant permission for individual firms to disapply or modify particular PRA rules. It also ensures that the PRA is subject to proportionate procedural safeguards in exercising its functions under section 138BA, as explained in paragraph 5.3 above. In summary, this approach preserves the strengths of the existing 138A mechanism for PRA rules, while providing increased flexibility and appropriate procedural safeguards.

7. Consultation

Summary of consultation outcome and methodology

- 7.1 Two public consultations were conducted on the government's proposals for adapting the UK regulatory framework for financial services to ensure that it remains fit for the future, and to reflect the UK's new position outside of the EU. The first consultation

was published on 19 October 2020¹. The second consultation was published on 9 November 2021², with the government’s response published on 20 July 2022³. A key objective of the government’s proposals was to deliver an agile regulatory regime using the FSMA model of regulation so that “requirements which apply to firms will be set through regulator rules, which can be updated in an agile and responsive way to take account of changing market conditions, address emerging risks, and facilitate innovation”. This objective received broad support from consultation respondents. This instrument will contribute to that objective by providing the PRA with flexibility in the application of its rules to individual firms.

7.2 HM Treasury have also consulted the PRA during the development of this instrument, as required by section 138BA(7) of FSMA.

8. Applicable Guidance

8.1 HM Treasury do not propose to provide any further guidance in relation to this instrument. It will be for the PRA to direct firms as to how they should apply to the PRA when requesting the disapplication or modification of PRA rules under section 138BA.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A de minimis Impact Assessment is submitted with this memorandum and published alongside the Explanatory Memorandum on legislation.gov.uk.

Impact on businesses, charities and voluntary bodies

9.2 There is no significant, impact on business, charities or voluntary bodies as a result of this instrument. While this instrument will grant the PRA additional flexibility to disapply or modify its rules made under FSMA, it will be for the PRA, which is operationally independent, to decide how that flexibility is used when responding to requests from individual firms. Assessing the impact of its approach to disapplying or modifying PRA rules will therefore be the PRA’s responsibility.

9.3 Where final impacts are dependent on the outcome of policy decisions which sit within the remit of the independent financial services regulators, HM Treasury are content that in such cases, the regulators have appropriate mechanisms to consider the impact of such decisions.

9.4 The legislation does not impact small or micro businesses.

9.5 There is no significant impact on the public sector because the affected public body, the PRA, already makes use of section 138A of FSMA and certain provisions in assimilated law to permit firms to flex regulatory requirements. While this instrument will provide a new mechanism, with increased flexibility for the PRA to permit the

¹ *Financial Services Future Regulatory Framework Review - Phase II Consultation*, 19 October 2020:

<https://www.gov.uk/government/consultations/future-regulatory-framework-frf-review-consultation>

² *Financial Services Future Regulatory Framework Review: Proposals for Reform*, 9 November 2021:

<https://www.gov.uk/government/consultations/future-regulatory-framework-frf-review-proposals-for-reform>

³ *Response to the Consultation*, 20 July 2022: <https://www.gov.uk/government/consultations/future-regulatory-framework-frf-review-proposals-for-reform>

disapplication and modification of PRA rules, the flexing of regulatory requirements is a well-established element of the PRA's regulatory responsibilities.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The approach to monitoring this legislation involves HM Treasury working with the PRA to monitor the use of this section 138BA instrument to ensure it provides the PRA with appropriate flexibility in the application of PRA rules and proportionate procedural safeguards for affected financial services firms.

10.2 The instrument does not include a statutory review clause, and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015, the Economic Secretary to the Treasury (Bim Afolami MP), has made the following statement:

“It is not proportionate to include a review clause in this instrument because the estimated annual net direct cost to business is less than £10 million.”

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 The Economic Secretary to the Treasury (Bim Afolami MP), has made the following statement regarding Human Rights:

“In my view the provisions of the Financial Services and Markets Act 2000 (Disapplication or Modification of Financial Regulator Rules in Individual Cases) Regulations 2024 are compatible with the Convention rights.”

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 (“relevant European Union Acts”). It does however relate to the withdrawal of the United Kingdom from the European Union because it relates to HM Treasury's programme to deliver a Smarter Regulatory Framework for the UK. The instrument will provide the PRA with the necessary flexibility to disapply or modify the application of PRA rules which can then be used to replicate some of the flexing provisions in assimilated law that are in the process of being repealed by FSMA 23.