EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2000 (THRESHOLD CONDITIONS) ORDER 2013

2013 No. 556

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 amends Schedule 6 to the Financial Services and Markets Act 2000 (the 2000 Act) to set out the threshold conditions that financial services firms must meet to become authorised under that Act by the Prudential Regulation Authority (PRA) or the Financial Conduct Authority (FCA). Failure by an authorised person to comply with the threshold conditions enables the relevant regulator to take certain action in relation to that firm (for example, to impose a requirement on the firm under sections 55L and 55M of the 2000 Act).

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

3.1 None.

4. Legislative Context

4.1 This order is made under section 55C of the 2000 Act, as inserted by the Financial Services Act 2012.

4.2 This order amends the threshold conditions (set out in Schedule 6 to the 2000 Act). The order also specifies, in relation to those who are, or will be, regulated by both the PRA and FCA which conditions are relevant to the discharge of the functions of the FCA or PRA.

4.3 Paragraph 5 of Schedule 20 to the Financial Services Act 2012 provides that before section 11 of the Financial Services Act 2012 comes into force in relation to section 55B of the 2000 Act, the Treasury must make an order under section 55C which amends or replaces Parts 1 and 2 of Schedule 6 to the 2000 Act and which makes provisions as to which conditions relate to the discharge by each of the FCA and PRA of is functions. This Order is intended to discharge that duty.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

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 (Threshold Conditions) Order 2013 are compatible with the Convention rights.

7. Policy background

7.1 The Financial Services Act 2012 provides for the reform of financial regulation in the UK. In the place of the Financial Services Authority (FSA), it establishes a new system of financial services regulators comprising:

- An expert macro-prudential authority, the Financial Policy Committee (FPC) within the Bank of England to monitor and respond to systemic risks in the financial sector;
- A focused micro-prudential regulator, the PRA, to regulate firms that manage complex risks on their balance sheets - specifically, all deposit takers, insurers and some large investment firms; and
- A focused conduct of business regulator, the FCA, to ensure that business across financial services and markets is conducted in a way that advances the interests of all users and participants.

7.2 The threshold conditions (TCs), set out in Schedule 6 to the 2000 Act, are the minimum requirements that firms need to meet in order to become authorised. They are also a key supervisory tool, and provide the basis for triggering certain powers of intervention in relation to the firm (including the power to vary or cancel permission) and are the basis for the triggering of the special resolution regime (SRR) provided for under the Banking Act 2009 to resolve failing banks and building societies.

7.3 In the new regulatory system, there will be separate sets of TCs for each regulator. This is important to ensure that there is clarity about each regulator's responsibilities. There will be:

- conditions for firms authorised and regulated by the FCA only;
- FCA-specific conditions for firms authorised by the PRA and subject to regulation by both the FCA and the PRA;
- PRA-specific conditions for insurance firms; and
- PRA-specific conditions for banks and investment firms which are regulated by both the FCA and PRA.

7.4 The Government has considered it preferable to set out separate TCs for which the PRA is responsible in relation to banks and investment firms on one hand, and insurers on the other hand, in recognition of their distinct characteristics. The TCs that apply to insurers are applied to the Society of Lloyds and the managing agents with modifications, given the distinct nature of the activities they carry on.

8. Consultation outcome

8.1 The Order was subject to full public consultation in the document “A new approach to financial regulation: draft secondary legislation”, which was published on the HM Treasury website on 15 October. The consultation closed on 24 December, in line with Government guidance on public consultation. The consultation included a draft of this Order.

8.2 Consultation respondents generally welcomed, or did not object to, the proposed approach the threshold conditions. A more detailed summary of respondents’ views is available from on the Treasury website, with the Government response.

8.3 There were some detailed comments on drafting. For example, one respondent considered that the concept of “probity” included in the Order is subjective. One respondent was concerned that “resources” was too widely defined. There were also specific points raised about the new content of the threshold conditions. For example, one respondent argued that they should include a specific requirement on firms “to ensure they treat every customer fairly”. Other respondents raised concerns around proportionality and fairness, particularly in context of the new requirement that firms must be capable of being supervised effectively by the regulator, and the FCA’s new ‘business model’ TC.

8.4 As set out in the summary of consultation responses, the Government has considered the drafting points that have been raised, and concluded that on balance the drafting is appropriate. The Government has also considered the content of the TCs, and believes that the new material is appropriate and will help to ensure that they can be used as an effective regulatory tool. The Government agrees that the regulators should be proportionate. This is given explicit recognition in the principles of regulation set out in section 3B of FSMA.

9. Guidance

9.1 Further guidance on how the new regulators will interpret the instrument will be made available by the PRA and FCA.

10. Impact

10.1 The instrument, in itself, does not impose any additional regulatory burdens on business, charities or voluntary bodies. The impact of the overall change to the regulatory system on business, charities or voluntary bodies, in so far as they are regulated financial services firms, is set out in the overarching impact assessment for the Financial Services Act 2012.

10.2 The impact on the public sector is set out in the overarching impact assessment for the Financial Services Act 2012.

10.3 An Impact Assessment has not been prepared for this instrument. Instead the overarching Impact Assessment that covers the changes to the regulatory system provided for by the Financial Services Act 2012 is available on the Treasury website as Annex H to the following publication: http://www.hm-treasury.gov.uk./d/condoc_fin_regulation_draft_secondary_leg.pdf.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 To minimise the impact of the requirements on firms employing up to 20 people, the PRA and FCA will be required by the Financial Services Act 2012 to 'have regard' to the principle of proportionality when carrying out their general functions through section 3B of the Financial Services and Markets Act 2000; specifically, that any burdens they impose should be proportionate to the benefits that are expected to result. Additionally, the PRA and FCA will be required to carry out and publish cost benefit analyses on any new requirements they impose.

12. Monitoring & review

12.1 HM Treasury will monitor the practical effects of this instrument to ensure it continues to meet the policy aims.

13. Contact

Chris Goodspeed at HM Treasury Tel: 0207 270 5690 or email: chris.goodspeed@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.