



What goes where? Theory and practice of designing rule systems: insights from EU & UK financial services

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Choices in designing rule systems

Rule type

- Legal status
 - Legally binding
 - Criminal (strict liability / other)
 - Civil or Administrative
 - Non legally binding
 - Guidance with evidential status
 - Non-binding guidance / codes etc
- Linguistic structure
 - Degree to which specific or general
 - Degree to which simple or complex
 - Degree to which vague or certain

- Institutional framework
- Author
 - Legislature / executive
 - Federal or state? Regional (eg EU) or member state?
 - Regulatory agency
 - Federal or state? Regional (eg EU) or member state?
 - Private actor / organisation
- Enforcer
 - Private action
 - Public actor – eg regulator
 - Contract – eg membership of self regulatory body / supply chain conditions
- Adjudicatory body
 - Court
 - Specialist tribunal
 - Regulatory agency
 - Other

Factors to consider in making choices in rule system design

- Functional
 - Communication – rule type
 - Adaptability – rule type; institutional framework
 - Enforceability – rule type; institutional framework
 - Other – eg coordination, harmonisation (in federal systems)
- Constitutional
 - Constitutional values
 - Rule of law – procedural values: law should be open, accessible, certain etc
 - Democratic values
 - democratic engagement
 - accountability to legislature, executive and courts
 - Distribution of powers
 - Separation of powers
 - Federal or regional vs state/ member state
- Political
 - Power and control
 - Ex ante determination of rules
 - Political engagement during the regulatory process
 - Degree of independence of regulatory agencies
 - Accountability arrangements

All feeds into the 'what goes where' debate

- Thinking purely functionally, there would be a rule system which combines rule types, with a clear institutional framework, eg
 - Enabling legislation sets out key provisions including:
 - Goals of the regulatory system
 - Powers and duties of other actors (state governments, regulatory agencies, courts, tribunals)
 - Key elements of the regulatory provisions
 - Defining the regulatory perimeter
 - Stipulation of regulatory framework, ie of key provisions at a general level
 - Specification of offences / liability rules
 - Specification of enforcement processes including rights of appeal
 - Secondary legislation contains
 - More detailed provisions
 - Adaptability mechanisms: ie powers and processes to enable adaptability of the regulatory system, eg extending the regulatory perimeter
 - Regulatory rules contain
 - Statements of principle elaborating on statutory goals and 'have regards'
 - Detailed and technical provisions
 - Regulatory guidance – elaborates on how to comply

But functional considerations are never the sole driver: the EU and UK experience

- EU
 - Drive for a single capital market
 - Lamfalussy reforms in 2001
 - Level 1 – Directives and regulations agreed at the political level
 - Level 2 – Detailed provisions made by the Commission
 - Level 3 – Guidance on implementation by member state regulators
 - Level 4 – Commission monitors implementation by member states
 - Post crisis reforms
 - Level 1 – greater use of regulations and stipulation of ‘maximum harmonisation’ measures to ensure uniform adoption across member states to address regulatory arbitrage and resilience (‘weakest link’ problem)
 - Level 2 – creation of 3 committees
 - Draft technical standards which are approved by Commission and directly applicable in member states (regulatory technical standards and implementation technical standards)

UK & EU – pre and post-Brexit

- Prior to Brexit, EU directives, regulations and binding technical standards for financial regulation were mainly incorporated directly into regulatory rules
- Post Brexit, the UK is in the process of re-organising its financial services regulation to align with the ‘British’ approach to rule system design set out in Financial Services and Markets Act 2000
 - EU (Withdrawal Act) 2018
 - In preparation for Brexit ‘cut over’ the body of EU law had to be incorporated into primary or secondary legislation: ‘on-shoring the acquis’
 - FCA and PRA powers to incorporate and amend EU rules in some areas
 - Financial Services Act 2021
 - Provided for the adoption of ‘in flight’ EU financial services laws which had been negotiated and agreed but not yet formally enacted (eg Basle III requirements and provisions for the prudential regulation of investment firms)
 - Act enabled Treasury to amend certain incorporated EU provisions by secondary legislation
 - Act empowered FCA and PRA to amend and implement ‘in flight’ EU rules
- Future Regulatory Framework Review- ‘the great sorting-out’
 - Consultation in November 2021
 - Bill expected to be published in June
 - Reorganisation of the rule system
 - Revisiting issues of regulatory independence and accountability