

**EXPLANATORY MEMORANDUM TO
THE FINANCIAL SERVICES AND MARKETS ACT 2000 (REGULATED ACTIVITIES)
(AMENDMENT) ORDER**

2013 No. 655

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 To amend the Financial Services and Markets Act (Regulated Activities) Order 2001 to create new regulated activities related to the setting of specified benchmarks, the first of which will be LIBOR (the London Inter-Bank Offered Rate)

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

- 3.1 None

4. **Legislative Context**

- 4.1 This Order implements a key recommendation of the Wheatley Review of LIBOR that the activities of providing information for the setting of LIBOR and the administration of LIBOR should become regulated activities under the Financial Services and Markets Act 2000 (“the Act”).

- 4.2 The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the “Principal Order”) sets out the activities which are regulated activities for the purposes of the Act. Any firm wanting to carry on these activities must first obtain permission to do so from either the Financial Conduct Authority or the Prudential Regulation Authority.

- 4.3 Following amendments to the Act by the Financial Services Act 2012 to allow activities connected to the setting of benchmarks to become regulated activities, this Order amends the Principal Order to introduce two new regulated activities, that of providing information in relation to a specified benchmark and that of administering a specified benchmark. The only benchmark that is specified at present is LIBOR.

- 4.4 This Order also makes a consequential amendment to the Act which ensures that the consumer objective of the Financial Conduct Authority will cover consumers affected by manipulation of benchmarks.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom

6. European Convention on Human Rights

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

6.2 “In my view the provisions of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2013 are compatible with the Convention rights.”

7. Policy background

7.1 LIBOR – or the London Inter-Bank Offered Rate – refers to a series of interest rate benchmarks. It is estimated that LIBOR is referenced in at least \$300 trillion-worth of financial contracts, both retail and wholesale, globally. In June 2012, it was revealed that LIBOR had been subject to repeated attempts at manipulation, as a result of the conclusion of investigations by the Financial Services Authority (FSA) and other international public authorities. Further investigations are underway.

7.2 Subsequently, the Chancellor of the Exchequer asked Martin Wheatley, to commence an independent review into the setting and usage of LIBOR, which is vital to the functioning of global financial markets. The findings and recommendations of the Wheatley Review were published on 28 September 2012 and can be found on the HM Treasury website, here: http://cdn.hm-treasury.gov.uk/wheatley_review_libor_finalreport_280912.pdf.

7.3 The Review identified a number of failings in the production and oversight of the process of determining LIBOR, which is currently administered by the British Bankers Association (BBA) and self-regulated by the BBA and the contributing banks. In particular, the Review noted that the conflicts of interest presented by self-regulation had clearly facilitated the conduct identified in the investigations.

7.4 Consequently, a key recommendation of the Wheatley Review was that the activity of banks in providing information (i.e. submitting) to LIBOR, as well as the administration and governance of LIBOR, should be brought within the scope of statutory regulation by the new Financial Conduct Authority (FCA). This is achieved by the creation of two new regulated activities in this Order, specifically (i) providing information to, and (ii) the administering of, a specified benchmark. The only benchmarks currently specified for these activities are LIBOR.

7.5 The Review also recommended that a specific criminal offence be created for the making of misleading statements and impressions relating to benchmarks, alongside other

market-led reforms. The Financial Services Act 2012 (Misleading Statements and Impressions Order) 2013 implements this recommendation.

7.6 Regulation of LIBOR-related activities will enhance the ability of the FCA to oversee and supervise firms' conduct in respect of those activities. In particular, it will significantly enhance the ability of the FCA to:

- write and implement specific rules in relation to the LIBOR process, which would – among other things – set out the systems and controls requirements that firms will need to have in place;
- supervise the conduct of both firms and individuals involved in the LIBOR process. Such supervision may include regular reviews of firms' procedures as well as an assessment of performance of the activities; and
- take appropriate regulatory action for any misconduct if a firm or approved person does not conduct itself or themselves according to the standards set out in the applicable regulatory requirements.

7.7 At present, the initial benchmarks that are to be brought within the scope of regulation are LIBOR. However, HM Treasury is able to specify further benchmarks, should it become clear that to do so would bridge a gap in the regulatory or enforcement powers of the regulatory authorities. Further work is ongoing, both domestically and internationally to assess whether further benchmarks should be specified for this purpose.

8. Consultation outcome

8.1 HM Treasury sought views from the public through a consultation process which lasted for just under 4 weeks and closed on 24 December 2012. The consultation document included a draft of this Order and can be found at: http://www.hm-treasury.gov.uk/d/implementing_wheatley_review281112.pdf.

8.2 In preparing this Order, the Treasury also benefitted from the consultation conducted by the Wheatley Review, which began in August 2012. Indeed, a number of responses to the Treasury's consultation stated that they had no further comments to those provided in response to the Wheatley Review.

8.3 In total, 14 respondents provided comments on the draft legislation, ranging from trade associations, banks, regulated investment exchanges, energy firms, financial index providers and commodity price reporting agencies. Two stakeholders also asked to discuss the proposals.

8.4 All respondents supported the overall policy aims of this Order. However, some made particular comments on the drafting. In particular, some respondents noted the link between the two activities – providing information and administering a benchmark – and sought clarification that the definition of “administering” captured all the necessary aspects of benchmark administration, as outlined in the Wheatley Review. HM Treasury believe that the activities as described in the Order sufficiently cover all aspects of benchmark administration.

8.5 There were also queries regarding the drafting of the transitional provisions (which allow a smooth transfer from an unregulated to a regulated environment) and the exclusion provisions in the Order. Subsequently, HM Treasury has made some minor changes: the existing LIBOR administrator is to receive an “interim permission” upon commencement and the exclusion provisions now preserve the link between the two activities.

8.6 The consultation also asked for views on extending the scope of benchmark regulation beyond the single set of benchmarks, LIBOR. Of those that commented, all respondents cautioned against the immediate extension of the scope of regulation beyond LIBOR. Most considered that it was vital for an international consensus and framework to be developed under the auspices of International Organisation for Securities Commissions (IOSCO) the Financial Stability Board (FSB) and the European Commission. The Government agrees with this view and considers that the international consensus does not at present support the specification of additional benchmarks for this purpose.

9. Guidance

9.1 The FSA has published a consultation paper outlining draft Rules and Guidance for firms carrying on the activities of providing information to, and the administering of, benchmarks more generally, but restricted to LIBOR initially in accordance with the contents of this Order. These Rules and Guidance will provide the framework for the FCA’s future supervision of the conduct of firms carrying out these activities. The consultation paper can be found at: www.fsa.gov.uk/static/pubs/cp12-36.pdf.

10. Impact

10.1 The impact on business is restricted to a subset of large financial firms (who provide information to LIBOR), of which there are 23. It also applies to the firm(s) who administers LIBOR. Firms who provide information to LIBOR will face costs arising from requirements imposed on them by the FCA in the course of supervision, as well as increased regulatory fees. The Treasury has estimated these costs at £44 million one-off costs and annual costs of £5.8 million. Additionally, the administrator of LIBOR is estimated to face one-off costs of £1.9 million, and annual costs of £300,000. There is no impact on charities or voluntary bodies.

10.2 There will be an impact on the public sector through increased costs of supervision by the FCA. These have been estimated by the Treasury at around £400,000 per annum and will be met through fee payments by the relevant authorised firms.

10.3 The implementation of this policy, through this Order, results in a LIBOR framework that is significantly less vulnerable to attempted manipulation and subject to much stronger governance and regulatory oversight. As a consequence, LIBOR – which is used in at least \$300 trillion-worth of financial contracts – will have substantially more

credibility and integrity among authorities, market participants and the public, and can therefore continue to serve as an important financial market benchmark.

10.4 An Impact Assessment is attached to this memorandum and has been published alongside the draft statutory instruments in the consultation document, which is available at http://www.hm-treasury.gov.uk/d/implementing_wheatley_review281112.pdf.

11. Regulating small business

11.1 The legislation does not apply to small business. It only applies to a subset of large financial firms (who provide information to LIBOR), of which there are 23. It also applies to the firm(s) who administers LIBOR.

12. Monitoring & review

12.1 Supervision of benchmark activities by the FCA is a novel activity. As a result, the FCA has announced that it intends to perform a review of the relevant firms in the first year of implementation of the supervisory regime. The FCA is able to modify and fine tune its rules to accommodate lessons learnt from this review. Should this review suggest that there are difficulties with the scope and effect of the Order, the Treasury will consider, and where appropriate implement, any recommendations made by the review.

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.