The Designated Activities Regime

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The UK's new Designated Activities Regime (the "**DAR**") is intended to deal with some of the complexities arising out of the patchwork financial services regulatory regime that has arisen in the UK following Brexit.

It should ultimately result in the full removal of "retained" EU law from the UK's financial services legislation, hopefully to make it clearer to understand and navigate. It will affect both unregulated and regulated firms that are engaged in activities relating to UK financial markets and products.

As a result of the United Kingdom's departure from the European Union, the rules applicable to financial market participants are spread across many sources of law, including retained EU law, primary and secondary domestic legislation, and the regulators' rulebooks. The creation of retained EU law via the "onshoring" process created stability and certainty, but it is cumbersome to navigate and more difficult to amend, and so was never intended to be an optimal or long-term approach to the regulation of UK financial services.

The DAR is a legislative framework that will sit alongside the current regulated activities regime and has been created to address these complexities on a long-term basis. It will become the primary way in which firm-facing rules will be made for activities relating to financial markets and products and will dovetail with the ongoing repeal and replacement of retained EU law. The ultimate goal of the DAR is for the FCA Handbook to become the primary source of rules applicable to financial market participants.

Although the HM Treasury and the Financial Conduct Authority have not published any firm timetable for the introduction of new regulations under DAR and the consequent repeal of retained EU law, the expectation is that this will happen during 2024 and 2025. As much of the intention of the DAR is to provide a clearer and more comprehensible structure for how UK financial services legislation is set out, we would not expect this to be a particularly "party-political" issue or (despite there not being any clear statement from the Labour Party) for any change in the UK government to significantly alter the roll-out of the DAR.

This article provides an overview of the DAR and details the rationale for its creation, the types of activities that could fall within scope, the consequences of an activity becoming a designated activity, and what firms should do to prepare.

1. **What is the DAR?**

The DAR is a regulatory framework that was inserted into Part 5A of the Financial Services and Markets Act 2000 ("**FSMA 2000**") by the Financial Services and Markets Act 2023. Its purpose is to act as a mechanism for the regulation by HM Treasury ("**HMT**") and the Financial Conduct Authority (the "**FCA**") of certain activities relating to financial markets and products.

The DAR is intended to be a "comprehensive FSMA-style framework" that shares many of the structural features of the current regulated activities regime. It is not, however, a replacement for the regulated activities regime and will instead sit alongside and complement it.

This essentially means that HMT will set the overall scope of the DAR by defining designated activities via secondary legislation (called "designated activity regulations") and conferring powers on the FCA to make rules relating to those designated activities. The FCA will then make the actual firm-facing rules that persons carrying out a designated activity need to abide by.

The key difference is that, unlike regulated activities, carrying out a designated activity does not inherently require the person carrying it out to become an authorised person (i.e., to obtain permissions under Part 4A of FSMA 2000), although carrying on a designated activity may involve the performance of regulated activities as well.

The DAR will also play an important role in the ongoing repeal and replacement of retained EU law (referred to as "assimilated law" as of 1 January 2024). The expectation is that the DAR will eventually encompass (but will not be limited to) the types of activities that are currently regulated by assimilated law, and that such law can be repealed as and when replacement rules under the DAR are ready to be implemented.

2. **Why is the DAR needed?**

The DAR is needed as the FCA's general rule-making powers are limited to authorised persons, and designated activities may be carried out by persons that are not authorised. The DAR therefore extends the FCA's rule-making powers beyond authorised persons, but subject to the limits set by HMT.

The alternative to the DAR would be to expand the regulated activities regime to include a broader range of activities connected to financial markets. However, this would have broad-reaching consequences and would require many more participants in the financial markets to become authorised and directly supervised by the FCA. The DAR therefore reflects the fact that designated activities pose risks to UK financial markets, but FCA authorisation is a disproportionate way to mitigate those risks.

The DAR also forms part of the UK government's longer-term aspiration to have the FCA Handbook serve as a single source for the firm-facing requirements applicable to market participants.

3. **What types of activities can be designated activities?**

HMT can only designate an activity as a designated activity if it relates or is connected to:

a. the financial markets or exchanges of the UK; or
b. financial instruments, financial products or financial investments that are (or are proposed to be) issued or sold to, or by, persons in the UK (which explicitly includes cryptoassets).

Designated activities can be framed in terms of the way in which the activity is carried on or by descriptions of the persons who carry it on.

The scope of the DAR is therefore extremely broad and only imposes loose limits on HMT.

4. **What activities might become designated activities?**

Schedule 6B to FSMA 2000 sets out an illustrative and non-exhaustive list of examples of the types of activity which may become designated activities. This list includes:

a. **Derivatives**: Activities related to entering derivative contracts (including contracts not cleared by a central counterparty) and holding positions in commodity derivatives.
b. **Short selling**: Engaging in short selling in relation to specified financial instruments.
c. **Securitisation**: Acting as an originator, sponsor, original lender, or securitisation special purpose entity in a securitisation or selling a securitisation position to a UK retail client.
d. **Capital markets**: Offering securities to the public or applying for, securing or maintaining the admission of securities to trading on a securities market.
e. **Benchmarks**: Issuing an instrument which references a benchmark, determining the amount payable under an instrument or financial contract by reference to a benchmark, being a party to a financial contract which references a benchmark, measuring the performance of an investment fund through a benchmark, acting as a benchmark contributor, or contributing data to a regulated benchmark administrator.

As expected, this list covers the types of activities that are currently regulated by assimilated law, including EMIR, the Short Selling Regulation, the Securitisation Regulation, the Prospectus Regulation, and the Benchmarks Regulation. However, the scope of designated activities will not necessarily be limited to activities covered by assimilated law and will inevitably evolve over time.

HMT has already made designated activities regulations relating to the public offer and admission to trading regime and the securitisation regime that designate certain activities related to those regimes as designated activities. HMT has also published a draft designated activity regulation related to the short-selling regime.

It is envisaged that there will eventually be a single statutory instrument (the "**DAR SI**") that sets out all designated activities (much like the Regulated Activities Order does for the regulated activities regime), as well as the FCA's supervisory, investigatory, and enforcement powers that apply across designated activities more generally.

The DAR is not expected to cover all areas of assimilated law and HMT has indicated that the regulation of certain types of financial markets infrastructure that currently sits outside of the FSMA authorisation regime will not fall under the DAR. This will include recognised investment exchanges, central counterparties, central securities depositories, payment systems, and trade repositories.

5. **What rules can the FCA make in respect of designated activities?**

The FCA is empowered to make rules relating to designated activities. However, that power can only be exercised to the extent provided for by HMT in designated activity regulations. The FCA also does not have the power to make rules for unrelated activities of a person carrying out a designated activity.

There will not be a single approach to rulemaking in connection with designated activities. Each designated activity will be subject to its own specific rules as well as the consequences for breaching those rules. We expect rules made under the DAR to be broadly modelled on those that firms are already familiar with.

We expect the FCA's rules to relate to the following matters:

a. **Date:** The date on which the relevant rules will come into force.
b. **Scope:** Definitions as to which activities will fall within the scope of the rules or descriptions of persons who carry on the activity that will be subject to the rules.
c. **Exclusions / Exemptions:** Parameters as to what activities fall outside of the rules and/or any persons that are exempt from the rules.
d. **Prohibitions:** Any prohibitions in relation to the activity.
e. **Rules:** Rules as to how the activity should be carried out and/or any other requirements which must be satisfied before an activity is carried out.
f. **Supervision:** Rules setting out exactly how the FCA will supervise the activity.
g. **Enforcement:** Rules setting out how the FCA can enforce compliance with the rules and investigate potential breaches.
h. **Breaches:** Rules setting out applicable consequences of breaching the rules.

6. **What are the consequences of an activity becoming a designated activity?**

The specific consequences will depend on the activity in question and the approach taken by HMT in the relevant designated activity regulation.

However, in broad terms, the consequences will be either:

a. a person can carry on the activity but must do so in accordance with the rules and requirements set by the FCA for that activity; or
b. the activity is prohibited to the extent specified by HMT (which may include only prohibiting specific categories of person from carrying on the activity).

The FCA may also use directions to impose requirements on specific persons, or categories of person, carrying on designated activities, again provided HMT has given the FCA the power to do so in the relevant statutory instrument. Such power can be used to direct a person carrying on a designated activity to take, or not to take, a specified action.

7. **What are the consequences for breaching the rules applicable to a designated activity?**

HMT has the power to use designated activity regulations to make provision about liability, compensation, and enforcement. Each designated activity will have its own framework for these purposes, which will be set out in the relevant regulations, but there will likely be a common set of powers that apply across all designated activities that will be set out in the DAR SI.

The consequences for breaching a rule or requirement applicable to a designated activity will therefore be context specific. However, and in contrast to breaches of the regulated activities regime, the "default" position will be that such breaches:

a. do not make a person guilty of a criminal offence;

b. do not make a transaction void or voidable; or
c. do not give rise to an action for breach of statutory duty.

HMT can expressly provide otherwise in the relevant designated activity regulations.

In terms of enforcement, HMT can make provision in designated activity regulations that:

a. require the supply of information;
b. concern investigations, including the making of reports;
c. confer powers of entry;
d. confer powers of inspection, search, and seizure;
e. confer powers of censure;
f. impose monetary penalties;
g. concern appeals; and
h. confer functions (including functions involving the exercise of a discretion) on a person.

These powers could be used to apply the existing FSMA 2000 enforcement powers (with or without amendments) to designated activities, rather than creating entirely new powers.

8. **What should firms be doing to prepare?**

Regulated and unregulated firms that engage in financial markets activities (particularly those currently covered by assimilated law) should prepare for the DAR by:

a. **Reviewing your financial markets activities**: Considering each of the activities it carries out to establish whether such activities are contemplated under the DAR and/or are likely to be contemplated in the future.
b. **Monitoring HMT's communications**: Monitor HMT's publications in respect of the DAR and any statutory instruments that designate activities as designated activities to establish whether any of the firm's activities are in-scope.
c. **Monitoring the FCA's communications**: Monitor the FCA's publications in respect of the DAR, particularly its consultation papers and policy statements in which it will set out its proposed firm-facing rules for designated activities. Firms should also analyse the extent to which any new rules include substantive policy changes versus the existing regimes and consider contributing to the FCA's consultations.
d. **Becoming familiar with the FCA Handbook**: Unregulated firms should familiarise themselves with the FCA rules and the FCA Handbook more generally as it will become the primary source of rules for designated activities.
e. **Review and revise compliance procedures**: Once details of the relevant rules become more apparent, firms will need to review their existing compliance framework and policies and procedures and consider whether and how they will need updating, which may involve updates to contractual documentation and giving internal training.

If you would like to discuss the implications of this article, please get in touch with your usual Fieldfisher contact or a member of the Financial Markets & Products team.