Consultation Paper

10/11**

Financial Services Authority

Implementing aspects of the Financial Services Act 2010

April 2010

FSA®

Financial Services Authority

Contents

The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by 25 June 2010.

Comments may be sent by electronic submission using the form on the FSA's website at (www.fsa.gov.uk/Pages/Library/Policy/CP/2010/cp10_11_response.shtml).

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A confidential response may be requested from us under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Tribunal.

Copies of this Consultation Paper are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

1 Overview

1.1 This Consultation Paper (CP) sets out our proposals on the use of some of our new powers and duties arising from the Financial Services Act 2010 (the Act).

1.2 The Act received Royal Assent on 8 April 2010. It contains a broad range of measures affecting the way in which the Treasury, the Bank of England and the FSA work together. It alters our statutory framework by amending the Financial Services and Markets Act 2000 (FSMA). The Act alters our powers and duties by giving us:

- a new regulatory objective to contribute to UK financial stability;
- a duty to establish a new consumer financial education body (our public awareness objective is expected to be removed subsequently);
- an extension of our powers to write general rules and to alter firms' regulatory permissions so that they can be used to meet each of our regulatory objectives;
- enhanced powers to control short selling;
- a power to make consumer redress scheme rules (which is to be commenced at a date not yet known);
- a number of new disciplinary powers (the Act also affects the use of our existing enforcement powers);
- a new power to gather information that is relevant to financial stability;
- a duty to make rules in relation to remuneration; and
- a duty to make rules in relation to Recovery and Resolution Plans.

Structure and scope

1.3 This paper describes our policy relating to certain provisions of the Act. These policies cover:

- using the short selling disclosure rule-making power (see Chapter 2);
- using the power to impose financial penalties on those who breach short selling rules (see Chapter 3)
- using the power to suspend firms and individuals (see Chapter 3);
- using the power to impose financial penalties on individuals who have carried out controlled functions without approval (see Chapter 3);
- using the financial stability information-gathering power (see Chapter 4); and
- altering our Fees Manual to give the Financial Services Compensation Scheme the power to levy for management expenses incurred when acting on behalf on another compensation scheme – if it cannot recoup those expenses from the other compensation scheme – and to reflect the Special Resolution Regime funding changes (see Chapter 5).

1.4 The provisions of the Act covered in chapters 2, 3 and 4 of this CP come into force two months after Royal Assent. The provisions in the Act relating to the Special Resolution Regime funding changes (covered in chapter 5) came into force on Royal Assent. The provisions on FSCS acting on behalf of other compensation schemes will be commenced by Treasury Order at a later date.

1.5 This CP also covers certain consequential changes to the FSA Handbook that reflect the changes made by the Act; the Appendices to this paper contain the draft Handbook text that is designed to achieve this. Due to the nature of the task, it is possible we may find other amendments before the final Handbook text is made. Other consequential changes resulting from the Act are to be commenced by Treasury Order, so we do not currently know when they will come into force. Draft Handbook text to reflect these changes is not included in this paper. Our aim is to bring the whole Handbook and associated material into line with the changes introduced by the Act in due course. We propose to make any additional consequential changes to the Handbook without further consultation if they do not have any policy effect.

1.6 We will publish a separate CP on remuneration issues by the end of the second quarter in 2010, which will include changes arising from the Act.

Target audience

1.7 The target audience for this paper includes authorised firms and unauthorised persons, in particular those whose business may have an impact on UK financial stability. The paper is also relevant to individuals who are carrying on or may carry on controlled functions without our approval and those who engage or would consider engaging in short selling, and those who provide services in relation to short selling. It is also of interest to the professional advisers to any of these persons.

Responding to this consultation

1.8 The consultation period ends on 25 June 2010. We consider this to be an appropriate amount of time taking into account:

- the desirability of a sufficiently long consultation period;
- the desirability of publishing policies on the use of our new powers promptly to ensure that they may be used in a transparent way in the event that we wish to use them shortly after commencement; and
- the focus of this consultation, which does not involve substantive rule changes affecting the behaviour required of firms.

CONSUMERS

The proposals in this CP on our new disciplinary and enforcement powers will also be of interest to consumers and consumer groups, to the extent that they relate to our credible deterrence approach to enforcement.

The proposed disclosure rules on short selling are capable of affecting consumers to the extent that they engage in short selling.

2 Short selling rules

Introduction

2.1 Part 8A of FSMA, as inserted into FSMA by the Act, provides us with powers to:

- require disclosure of information about short selling and prohibit short selling in specified cases;
- require information or documents to be produced to determine whether short selling rules have been contravened; and
- impose penalties or issue censures in the event a person has contravened short selling rules.

This chapter sets out our proposals for the rules we intend to make under these powers, pending agreement of a detailed European framework on short selling.

2.2 As has been our stated position since 2008, we reserve the right to ban short selling, either across the board or in a targeted fashion, should we reach the view that circumstances justify this and we would be prepared to do this without consultation if appropriate. We have no current plans to introduce any such ban.

2.3 However, we currently have provisions regarding disclosures of significant short positions in two cases: where a company is undertaking a rights issue; and in relation to UK financial sector stocks (banks and insurance companies and their parent undertakings). We propose to take advantage of the greater flexibility the new powers provide us to remake the short selling disclosure measures as rules in a new module of our Handbook (the Financial Stability and Market Confidence sourcebook). The new rules will not be tied to the market abuse regime and we propose to delete the current provisions in the Code of Market Conduct once these new rules come into force. The provisions will be carried forward largely unchanged in substance. However, we are proposing a change to the rights issue disclosure regime to narrow the scope of the companies to which the regime applies. This means that, in effect, the disclosure regime would be restricted to UK companies and companies for whom a UK prescribed market is the main or sole trading venue for their securities.

Background

2.4 We have set out our general position on short selling in a Discussion Paper (DP09/01) and the subsequent Feedback Statement. We regard short selling as a legitimate investment technique in normal market conditions, but we have noted that – especially in turbulent markets – it can have negative impacts, both inadvertently and through wilful misconduct. We have set out our view that, except for temporary restrictions on short selling in exceptional circumstances, we favour dealing with the problems through enhanced disclosure. We have made clear that we intended to await the finalisation of a European short selling regime before we introduced any comprehensive disclosure requirements.

2.5 However, there are currently two limited short selling disclosure regimes dating back to 2008. In June 2008 we decided to introduce measures relating to a one-off disclosure of net short positions of 0.25% and above in relation to companies engaged in a rights issue. Then in September 2008, accompanying the 'ban' on the active creation or increase of net short positions in UK financial sector companies, we introduced a disclosure provision for significant short positions in such companies (the disclosure provision). All these various measures were implemented using our market abuse powers through amendments to the Code of Market Conduct.

2.6 In January 2009 we allowed the ban to expire, but extended the disclosure provision in relation to UK financial sector companies until 30 June 2009. In June 2009 we extended the disclosure provision in its current form without time limit. However, we noted that we did not intend that disclosure provision to apply permanently. Our expectation was that it would either be superseded in due course by broader permanent disclosure measures – preferably agreed on the widest possible international basis – or be revoked.

Disclosure proposals

2.7 We remain of the view that, pending the adoption of a permanent short selling disclosure framework, the two disclosure regimes should be continued. However, we are persuaded by arguments that both the market and the FSA would be better served if short selling disclosure requirements were enshrined in separate rules in our Handbook and were not specifically tied to the market abuse regime. Remaking the rules under the new powers will also allow us to bring greater legal certainty and clarity with little or no additional compliance burden. In particular, the new Handbook text will include matters contained in the FAQs about the current regime. Accordingly, we propose using the new powers in the Act to make rules requiring those who hold significant net short positions in UK financial sector companies and companies engaged in a rights issue to disclose those positions and the identity of the position holder to the market as a whole. Neither of the regimes is intended to be permanent. We still expect these rules to be superseded once a European short selling disclosure regime has been finalised, and we will consult on its implementation.

Q1: Do you agree with our proposal to re-cast the current disclosure obligations, contained in the Code of Market Conduct, as new FSA rules in the Financial Stability and Market Confidence sourcebook of the FSA Handbook?

Scope of the regimes

2.8 We consider that the present scope of the disclosure obligations affecting net short positions held in UK financial sector companies remains appropriate. At this stage we do not want to extend the scope of the disclosure obligations before finalising a comprehensive regime at international level. Accordingly, we propose that holders of significant net short positions in UK banks, UK insurers and the UK-incorporated parent undertakings of UK banks and UK insurers, as defined in the Glossary to the FSA Handbook, should be required to disclose those positions.

2.9 Regarding rights issues, we are conscious that the scope of the regime currently set out in MAR 1.9.2A applies to all qualifying instruments admitted to trading on a prescribed market whose issuer is undertaking a rights issue. It therefore applies to a much wider range of companies than UK issuers and non-UK companies for whom a UK prescribed market is their sole or main trading venue. In particular, it requires disclosure of significant net short positions in the shares of issuers with no significant link to UK markets and for whom there may be no short selling disclosure requirement in their home jurisdiction.

2.10 Our view is that the current scope of the rights issue regime potentially imposes a compliance burden that cannot always be justified by the benefits it brings. Our proposal is to reduce the scope of the companies to which this disclosure obligation applies – so it applies to UK-incorporated companies and non-UK companies where a UK prescribed market is the main or sole venue for trading in the company's securities.

Q2: Do you agree that it is appropriate to narrow the scope of the rights issue disclosure obligation as proposed?

Disclosure thresholds

2.11 In remaking the regimes under the new short selling powers, we have considered whether to modify the thresholds that trigger an initial disclosure obligation. We recognise that CESR has recommended a higher initial public threshold (0.5%) for its general European short selling disclosure regime. However, this would be accompanied by a system of private disclosures to regulators, starting at a lower 0.2% threshold. Until the general disclosure regime is implemented we consider it appropriate to keep the existing thresholds for the financial sector companies and rights issue disclosure regimes as they are.

2.12 Holders of net short positions of 0.25% and above in UK financial sector companies should disclose those positions to the market as a whole. As before, when positions

above 0.25% change by 0.1%, those changes should also be disclosed. A disclosure should also be made when the person's net short position falls below 0.25%. During a rights issue period, the requirement will continue to be to make a public disclosure when the net short position reaches or exceeds 0.25% on a one-off basis.

2.13 Disclosures should continue to be made by means of an announcement on a Regulatory Information Service (RIS).

2.14 We provided a cost benefit analysis (CBA) of short selling disclosure requirements in CP09/1, CP09/15 and DP09/1. This CBA presented the arguments about whether the potential benefits of individual disclosure of short positions can outweigh the costs (i.e. potentially reduced liquidity/efficiency and herding effects) and concluded that they do. We still consider this analysis to be valid. Given that the current regime only applies to those with a net short position greater than 0.25% of the issued capital of the relevant companies, and given the information that has been provided to us by market participants on costs of compliance when we were conducting our CBA, we still believe that the costs of the disclosure obligations would be proportionate.

2.15 As before, during a rights issue period and for financial sector companies, investors are expected to calculate their net short positions at the end of each day and, if they have reached a disclosure threshold, ensure that disclosure is provided to the market by 3.30pm on the next business day. For the reasons already discussed in DP09/1, we do not believe that the benefits of receiving information on thresholds that are reached intra-day would justify the considerable costs involved.

Q3: Do you have any comments on our proposal to maintain the disclosure requirements, including the thresholds, unchanged?

How to calculate net short positions

2.16 We are also proposing to keep the methodology for calculating a short position set out in our FAQs. All economic interests in the issued capital of the issuer should be taken into account to determine the investor's economic exposure. Any financial instrument (i.e. contracts for differences, spread bets, options, etc) may give rise to an economic exposure. The issued capital of a company has its ordinary meaning and includes ordinary shares and preference shares, but excludes debt securities (including convertible bonds).

2.17 Any economic interest held as part of a basket, index or exchange-traded fund would need to be included when calculating the position in a particular company. This would also apply to trading in any derivative products relating to an index. While we recognise that such calculations might be complex, to exclude this type of instrument would make it easy to avoid the regime and render it ineffective.

2.18 Any derivative instruments should be accounted for on a delta adjusted, rather than a notional, basis.

2.19 A person should be able to net their long and short interests in an issuer to calculate their net short position. Net short positions held intra-day would not have to be disclosed provided that the position held at the end of that day does not reach any of the disclosure thresholds (i.e. either the initial threshold or, in the case of a change of position in a UK financial sector company, the incremental threshold).

2.20 When calculating a net short position, a person should only include economic interests in the issued capital of the company. Also, during a rights issue period, a person should not be able to net a short position in the company's existing capital with a long position in the nil-paid rights. However, a short position in the nil-paid rights should be taken into account when calculating the overall net short position in the company. A significant short position in the nil-paid rights can have an effect on the price of the rights and in turn this can affect the price of the undiluted shares. So we consider that such a position should be taken into account when calculating the net short position.

2.21 Calculating changes of short position should be undertaken in the same way as calculating a person's net short position. By way of clarification, if a person swapped an existing instrument that gave rise to a net short position in a company with another type of instrument in the same company, they would only have to make an incremental disclosure if there was a change in their overall delta that took the position across another reporting threshold. If there were no change in delta, no further disclosure would be required.

Q4: Do you agree with the approach to calculation of net short positions, including changes of position, we propose? Are there any additional issues about which you believe we should make rules or provide guidance?

Netting

2.22 Where more than one company in a group of companies holds a net short position in another company, we do not think it is appropriate to net positions at group level, because in many cases that would result in the netting of positions taken in the context of completely different activities or strategies (e.g. long-term investments, short-term proprietary trading, investment management and so on). Additionally, it is necessary to ensure that holders of net short positions are not able to use a group structure to dilute their holdings and avoid compliance with the disclosure rules. Instead, where a structure has more than one legal entity, our view is that positions should be netted at legal entity level. If trading desks within a firm are housed within the same legal entity, the aggregate position of the trading desks within the legal entity should apply for these purposes, excluding positions taken under the market maker exemption (see below).

Q5: Do you agree with the approach to netting of net short positions, that we propose? Are there any additional issues about which you believe we should make rules or provide guidance?

Who is subject to the disclosure obligations?

2.23 Our view is that the disclosure obligation should continue to apply to the holder of the net short position. However, we do believe that there are some nuances in the case of investment managers and authorised fund managers who act on behalf of clients.

2.24 If an investment manager or authorised fund manager manages on a non-discretionary basis, the disclosure obligation should apply to the client, although it will be possible for the client to arrange for the investment manager to make the disclosure on their behalf.

2.25 In the case of discretionary management, the disclosure obligation should apply both at the level of the beneficial holder of the net short position (the client) and at the level of the investment manager or authorised fund manager. We consider it acceptable for investment managers or authorised fund managers to make disclosures on behalf of their clients. Regarding its own disclosure, the investment manager or authorised fund manager should disclose its aggregated net short position across all of the funds it manages on a discretionary basis.

2.26 We continue to hold the view that market makers should be exempt from the disclosure obligations and the new rules will therefore provide such an exemption following the lines under which we have operated so far. We believe that market makers should not have to disclose significant short positions as long as these are the result of genuine market making activity in accordance with existing general lines of business. This exemption covers market makers only when, in the particular circumstances of each transaction, they are acting in that capacity. In any event, we would not expect market makers to hold significant short positions, other than for brief periods.

Q6: Do you have any comments on our proposals concerning who is covered by and who is exempt from the disclosure obligations?

Cost benefit analysis (CBA)

2.27 When proposing new rules, we are obliged (under section 155 of FSMA) to publish a CBA, unless we consider that the proposals will give rise to no costs or to an increase in costs of minimal significance.

2.28 FSMA requires us (under section 157) to consult publicly on guidance before we issue it formally. However, the Regulatory Reform Order has lifted the requirement that, as part of a consultation on proposed guidance on rules, we must publish a CBA. In PS07/10[1] we have set out the factors we will consider when we decide whether to undertake and consult on a CBA of proposed guidance. As a matter of policy, we provide a CBA for significant proposed guidance relating to rules.

2.29 The CBA is an estimate of the costs and an analysis of the benefits that will arise from the proposals. It is a statement of the differences between the baseline (broadly speaking, the current position) and the position that will arise if we implement the proposals.

Disclosure requirement for UK financial sector companies

2.30 We are proposing to move the short selling disclosure provisions from the Code of Market Conduct to a new module of the FSA Handbook. The content and application of the rules will not change compared to the current situation. Therefore this rule change will not lead to incremental costs and benefits. A CBA has been provided in CP09/1 and CP09/15 when the short selling disclosure provisions in its current form have been introduced (CP09/1) and extended (CP09/15).

Disclosure requirement for companies in a rights issue period

2.31 We are also proposing to move the disclosure provisions relating to companies in a rights issues period from the Code of Market Conduct to a new module of the FSA Handbook. We propose that the rights issues short selling disclosure obligation only applies in the future to UK companies and to non-UK companies where a UK prescribed market is the main or sole venue for trading in the company's securities. This change reduces the scope of companies to which the disclosure obligation relates and will reduce compliance costs to firms.

2.32 Apart from the change in scope, the content and application of the rules will not change compared to the current situation. Therefore we believe that this rule change will lead to incremental costs and benefits of no more than minimal significance. The original disclosure provisions for companies in a rights issue period were introduced as urgent amendments to the Code of Market Conduct in June 2008 and, as such, were not consulted on. However, a CBA was provided in DP09/1, where we undertook a comprehensive review of short selling.

Guidance

2.33 We are proposing to give guidance on the new rules. The intention of this guidance is to clarify the application of the disclosure provisions. We believe the guidance has no cost implication over and above the short selling disclosure rules. Currently most of the areas of the proposed guidance are covered in the short selling FAQs.

1 http://www.fsa.gov.uk/pubs/policy/ps07_10.pdf

Compatibility statement

2.34 The proposals set out in this chapter aim to meet our statutory objective of maintaining confidence in the UK financial system. The proposals seek to reduce the risks posed by the negative impacts of short selling and contribute to the protection and enhancement of the stability of the UK financial system. First, continued short selling transparency would help all market participants judge the extent to which price changes in UK financial sector companies and companies undertaking a rights issue are being driven by significant short selling and make a better assessment of the supply and demand for financial instruments in these companies. Second, the disclosure obligations could help us detect abusive short selling in the relevant securities. Finally, the proposals would help reduce the risks of price over-shooting and disorderly markets. Disorder in the markets for systemically-important firms can undermine the UK's financial stability as a whole. Overall it is our view that this transparency helps maintain market confidence and financial stability.

Compatibility with the need to have regard to the principles of good regulation

2.35 Section 2(3) of FSMA requires that, in carrying out our general functions, we should have regard to the principles of good regulation. The most relevant principles in this context are set out below.

Proportionality

2.36 Any restrictions we impose must be proportionate to the benefits that are expected to result from those restrictions. We conducted a CBA for CP09/1 and DP09/1, and draw on the results of these CBAs here. Both included a survey of firms to assist us in understanding the costs of disclosure obligations, to help inform this consultation. Our conclusion (subject to feedback arising out of this consultation process) is that maintaining disclosure obligations, but re-casting them as new FSA rules, would be a proportionate measure.

The need to use our resources in the most efficient and economic way

2.37 The disclosure obligation places the onus on significant short sellers of the relevant financial instruments to disclose their positions to the market, so our role in the direct operation of that measure would be limited. We also believe that our risk-based approach to monitoring compliance with the disclosure obligations is an efficient and economic use of our resources.

The desirability of facilitating innovation in connection with regulated activities

2.38 While the enhanced transparency achieved through the disclosure obligations might deter some short selling and thereby potentially some innovation, we believe that such an unintended cost is outweighed by the benefits of the measures.

The international character of financial services and markets and the desirability of maintaining the competitive position of UK-regulated firms

2.39 We believe that continuation of the disclosure obligations, substantially unchanged, is unlikely to have a significant adverse effect on the competitive position of UK-regulated entities. Measures relating to short selling have also been put in place in a number of other jurisdictions and we are cooperating with overseas regulators on short selling issues.

Competition

2.40 We do not believe that these proposals would adversely effect competition between the firms we regulate.

3 Enforcement powers

3.1 This chapter sets out our proposed policy for the new enforcement powers given to us under the Act:

- the power to impose suspensions or restrictions on authorised and approved persons;
- the power to impose penalties on persons that perform controlled functions without approval; and
- the power to impose financial penalties on persons who breach short selling prohibition rules or short selling disclosure requirements.

Background

3.2 Under the Act our enforcement powers have been amended as follows:

- we have been given a new power to impose suspensions or restrictions on authorised persons, under section 206A of FSMA, and on approved persons, under section 66 of FSMA (the 'suspension power');
- we have been given a new power to impose penalties on persons that perform controlled functions without approval, under section 63A of FSMA (the 'non-approved persons penalty power');
- the restriction on imposing a financial penalty and withdrawing a person's authorisation previously contained in section 206(2) of FSMA has been removed;
- the time for taking action against an approved person for misconduct contained in section 66(4) of FSMA has been extended from two to three years; and
- we have been given a new power to impose financial penalties on persons who breach short selling prohibition rules or short selling disclosure requirements, under section 131G of FSMA (the 'short selling penalty power').

3.3 These amendments to FSMA come into force on 8 June 2010.

3.4 We are required by FSMA to prepare and issue a statement of our policy for:

- the imposition of suspensions or restrictions on authorised and approved persons;
- the period for which suspensions or restrictions are to have effect;
- the imposition and amount of penalties for carrying out a controlled function without approval;
- the imposition and amount of penalties for breach of short selling rules; and
- the procedure for giving warning notices and decision notices under section 395 of FSMA. This applies in relation to the suspension power, the non-approved persons penalty power and the short selling penalty power.

3.5 Our proposed policy about the suspension power and the non-approved persons penalty power will result in changes to the Decision Procedure and Penalties manual (DEPP). We also propose to make consequential changes to DEPP, the Enforcement Guide (EG) and the Glossary.

The suspension power

3.6 Where an authorised person has breached our rules, or other regulatory requirements, the suspension power enables us to suspend any permissions the person has to carry on a regulated activity, or to impose restrictions on the carrying on of a regulated activity by the person. Similarly, for approved persons, the suspension power enables us to suspend a person from performing one or more controlled functions for which they are approved, or restrict the performance by them of one or more controlled functions for which they are approved. We can impose a suspension[2] on an authorised person for a period not exceeding 12 months and on an approved person for a period not exceeding two years. Our proposed policy for the suspension power is set out in a new chapter of DEPP – DEPP 6A.

The circumstances in which we will use the suspension power

3.7 The suspension power is a disciplinary measure which we may use in addition to or instead of imposing a financial penalty or public censure. It is a different type of sanction to a financial penalty. This is because a suspension can be clearly and visibly linked to the misconduct, as it can be targeted at a particular activity, and can have an immediate effect on how a business operates or on an individual's ability to work. For example, if the breach of our rules has been carried out by a particular trading desk, we could prevent that desk from trading for a specified time.

2 For the purposes of this CP we will use the terms "suspension/suspend" to cover both the power to suspend and the power to impose restrictions.

3.8 The suspension power is a useful addition to our tool kit. It is important for any enforcement agency to have a wide range of enforcement tools, as has recently been noted in a study carried out for the Office of Fair Trading:[3]

'Deterring firms from anti-competitive activities is a key element of an effective competition regime. However economic literature suggests that the levels of fines currently seen are, by themselves, not sufficient to achieve optimal deterrence of anti-competitive activities. Whilst raising fines can increase the level of deterrence it is not necessarily the only way nor is it without associated costs. Higher fines can increase the cost of errors, may (in some situations) lead to insolvency and may not deter individual managers. *For these reasons the literature suggests complementary means of achieving deterrence should be used alongside fines* including individual sanctions, leniency, settlement and private actions.' (Emphasis added.)

3.9 We consider that our policy for the suspension power should reflect that it is a different type of sanction to a financial penalty, and that it adds to our options for taking appropriate enforcement action. Accordingly, we do not favour a policy of using the suspension power only in circumstances where we consider the appropriate financial penalty for the breach to be an inadequate deterrent. To adopt such an approach would link the suspension power to our power to impose financial penalties, whereas we consider the powers to be of a different nature. In addition, such an approach would limit the use of the suspension power, rather than allow us to use the most effective sanctions in a particular case.

3.10 Our suggested policy, set out in DEPP 6A, avoids these difficulties. Our proposed approach is to use the suspension power where we consider that the imposition of a suspension will be a more effective and persuasive deterrent than the imposition of a financial penalty alone. We believe there will be circumstances where this will be the case because, as mentioned above, suspending a person from carrying on particular activities could have a more direct and visible effect on that person than a financial penalty. For example, if we prevent a firm from selling a particular product for a period of time, this action is likely to have a more immediate and practical effect on the firm, and be more obvious to external parties and therefore a greater deterrent, than the imposition of a financial penalty.

3.11 In DEPP 6A.2.3 we provide a non-exhaustive list of examples of circumstances where we may consider it appropriate to use the suspension power:

- where we, or a previous regulator, have previously disciplined the person, as this would suggest that the previous action taken was not sufficient to deter the person from breaching our rules or other regulatory requirements;
- where we have previously taken action for similar breaches, as this would suggest our action was not sufficient to deter others from committing similar breaches;

3 Paragraph 1.4 of London Economics' report: *An assessment of discretionary penalties regimes* – http://www.oft.gov.uk/shared_oft/economic_research/oft1132.pdf

- where the person has failed to properly carry out an agreed redress package or other agreed remedial measures, as suspending the person would send a clear message about how seriously we regard the proper carrying out of remedial action;
- where the misconduct appears to be widespread across a number of individuals across a particular business area (suggesting a poor compliance culture), as suspending that business area would demonstrate a clear link between the sanction imposed and the reason for the disciplinary action;
- where a firm's competitive position in the market has improved as a result of the breach, as suspending the firm is more likely to redress the advantage unfairly gained by the firm than a financial penalty; and
- where a financial penalty is reduced for serious financial hardship reasons, as a person would then face punitive measures appropriate for the breach. We would not use the suspension power in these circumstances if we considered its imposition would itself cause serious financial hardship.

3.12 In determining whether it is appropriate to impose a suspension, we will look at all the circumstances of the case, and will take into account relevant factors. These factors may include those relevant for determining whether to impose a financial penalty or public censure, listed in DEPP 6.2. These include:

- the nature, seriousness and impact of the breach;
- the conduct of the person after the breach; and
- the person's previous disciplinary record and compliance history.

3.13 We expect to usually suspend a person from carrying out activities directly linked to the breach. However, in certain circumstances, we may also suspend a person from carrying out activities that are not directly linked to the breach – for example, if a firm's relevant business area no longer exists or has been restructured.

The length of the period of suspension or restriction

3.14 Under sections 69(2) and 210(2) of FSMA, our policy for determining the length of the period of suspension (the 'suspension period') must include having regard to:

- the seriousness of the misconduct in question in relation to the nature of the principle or requirement concerned;
- the extent to which the misconduct was deliberate or reckless; and
- whether the person against whom action is to be taken is an individual.

3.15 We will look at all the circumstances of the case in determining the length of the suspension period. We will decide upon a length that we consider appropriate for the breach concerned and is a sufficient deterrent, having regard to relevant factors.

3.16 Factors that may be relevant include those for when we determine the appropriate level of a financial penalty. For authorised persons, we may therefore have regard to the factors included at Step 2 (seriousness of the breach) and Step 3 (aggravating and mitigating factors) of the penalty-setting policy for firms (DEPP 6.5A). For approved persons, we may have regard to the factors included at Step 2 (seriousness of the breach) and Step 3 (aggravating and mitigating factors) of the penalty-setting policy for individuals (DEPP 6.5B).

3.17 Examples of Step 2 factors, for both firms and individuals, include:

- factors relating to the impact of the breach – for example, the level of benefit gained or loss avoided, or intended to be gained or avoided, by the person from the breach, either directly or indirectly;
- factors relating to the nature of the breach – for example, the frequency of the breach;
- factors tending to show the breach was deliberate – for example, if the person sought to conceal their misconduct; and
- factors tending to show the breach was reckless – for example, if the person appreciated there was a risk their actions or inaction could result in a breach, and failed to adequately mitigate that risk.

3.18 Examples of Step 3 factors, for both firms and individuals, include:

- the conduct of the person in bringing (or failing to bring) the breach to our attention quickly, effectively and completely;
- the degree of cooperation the person showed during our investigation of the breach; and
- the person's previous disciplinary record and general compliance history.

3.19 We recognise that imposing a suspension on a person is likely to have an impact both on that person and on others. We will therefore also take into account the likely effect of a suspension in determining the appropriate length of the suspension period.

3.20 In considering the effect of suspending an authorised person, the following considerations may be relevant:

- their expected lost revenue and profits from not being able to carry out the suspended activity;
- the cost of any measures they must undertake to comply with the suspension;
- potential economic costs – for example, the payment of salaries to employees who will not work during the suspension period;
- the effect on other areas of their business; and
- whether the suspension would cause them serious financial hardship.

3.21 In considering the impact of suspending an approved person, the following considerations may be relevant:

- their expected lost earnings from not being able to carry out the suspended activity; and
- whether the suspension would cause them serious financial hardship.

3.22 Factors that may be relevant in our assessment of the impact on others of imposing a suspension include the effect on markets and the extent to which consumers may suffer loss or inconvenience as a result. For example, a longer suspension period is likely to have more of an impact if it is difficult for consumers to switch to a competitor.

3.23 We will fully weigh up all these factors to determine the appropriate length of the suspension period, having regard to the need for deterrence. This means the likely cost to a person of being suspended will not automatically translate to a particular period of time. Rather, the likely cost to the person is just one of many factors that will be relevant in determining the appropriate length of suspension.

3.24 We may delay the start of the suspension period if we consider it appropriate. This is particularly likely to be the case for authorised persons, who may need a short period of time to, for example, make changes to their systems and controls to stop or limit the activity in question.

The interaction between the suspension power and financial penalties

3.25 The suspension power may be exercised instead of or in addition to the power to impose financial penalties and the power to impose a public censure. Our proposed approach regarding the interaction between the suspension power and a financial penalty or public censure is set out in DEPP 6A.4.2.

3.26 There will usually be three main stages in the interaction between suspension and penalties. First, we will decide whether it is appropriate to impose a penalty and whether it is appropriate to impose a suspension. These decisions will be made independently, following the approaches set out in DEPP 6.2 and 6A.2 respectively.

3.27 Secondly, if we consider that both a penalty and a suspension are appropriate, we will calculate the appropriate penalty level and the appropriate length of the suspension period, following the approaches set out in DEPP 6.5A to 6.5D and 6A.3 respectively.

3.28 Thirdly, we will consider whether the combined impact of the penalty and suspension is likely to be disproportionate to the breach and the deterrent effect of the sanctions. If so, we will reduce either the level of the penalty, the length of the suspension period, or both, so that the combined impact is proportionate to the breach and the effect of the sanctions. What sanction we reduce will depend on the facts of the case.

3.29 We will also take into account any representations that the combined impact of the sanctions will cause the person serious financial hardship in determining the final level of penalty and suspension period. Our approach to assessing serious financial hardship is set out in DEPP 6.5D.

3.30 One situation where we will depart from this approach is where we consider it appropriate to impose a suspension because the determined level of penalty is reduced for financial hardship reasons. In this case, we may consider it appropriate to impose a suspension after we have determined the appropriate penalty level, even if at the outset we did not consider it appropriate to impose a suspension. However, we may decide not to impose a suspension in these circumstances if we consider the suspension itself will cause serious financial hardship.

Decision maker

3.31 We consider that the Regulatory Decisions Committee (RDC) should be the decision maker for giving warning notices and decision notices for cases where the suspension power is used. This is consistent with the fact that the same sections of FSMA for giving warning and decision notices (section 66 for approved persons and sections 207 and 208 for authorised persons) apply to the suspension power as they do to the power to impose a financial penalty or public censure.

Q7: Do you have any comments about our proposed policy for the suspension power?

The power to impose penalties on persons that perform controlled functions without approval

3.32 The non-approved persons penalty power enables us to impose a penalty on a person, of an amount we consider appropriate, if we are satisfied that:

(a) the person has at any time performed a controlled function without approval; and

(b) at that time the person knew, or could reasonably be expected to have known, that they were performing a controlled function without approval.

3.33 FSMA requires that certain roles within authorised firms can only be performed by persons who have been approved by us. Before the Act introduced the non-approved persons penalty power, the only action we could take against an individual who was not approved, but was performing one of these roles within an authorised firm, was to prohibit the person from working in the industry. However, in many cases a prohibition by itself would not act as a sufficient deterrent, as a person could keep the financial benefit derived from their misconduct. Also, in some cases a person's conduct may not warrant a prohibition and so no sanction could be imposed. The introduction of the non-approved persons penalty power therefore closes a loophole within FSMA.

3.34 Under section 63C(2) of FSMA, our policy in determining whether a penalty should be imposed and the amount of a penalty must include having regard to:

(a) the conduct of the person on whom the penalty is to be imposed;

(b) the extent to which the person could reasonably be expected to have known that a controlled function was performed without approval;

(c) the length of the period during which the person performed a controlled function without approval; and

(d) whether the person on whom the penalty is to be imposed is an individual.

3.35 Under section 63C(3) of FSMA, our policy in determining whether a penalty should be imposed on a person must also include having regard to the appropriateness of taking action against the person instead of, or in addition to, taking action against an authorised person.

3.36 Under section 63C(4) of FSMA, a statement of policy issued under section 63C of FSMA must include an indicator of the circumstances where we would expect to be satisfied that a person could reasonably be expected to have known they were performing a controlled function without approval.

3.37 Our proposed policy regarding the non-approved persons penalty power requires amendments to DEPP chapter 6.

The circumstances in which we will impose a penalty on a person that has performed a controlled function without approval

3.38 DEPP 6.2 sets out our policy for deciding whether to take action to impose a financial penalty or public censure. We propose to adopt this policy for the non-approved persons penalty power as this will ensure consistency in how we approach these decisions. This means that, in accordance with DEPP 6.2.1, we will consider the full circumstances of each case when determining whether to take action and, in doing so, will take into account relevant factors. These factors may include those listed in DEPP 6.2.1, which fall under the following six categories:

- the nature, seriousness and impact of the suspected breach;
- the conduct of the person after the breach;
- the previous disciplinary record and compliance history of the person;
- FSA guidance and published materials;
- action taken by us in previous similar cases; and
- action taken by other domestic or international regulatory authorities.

3.39 In addition to these factors, we will have regard to additional considerations when deciding whether to take action against a person that performs a controlled function without approval. These additional considerations are set out in DEPP 6.2.9A, and include:

- whether, if the person had been approved, their actions would have amounted to misconduct for which we could take action pursuant to section 66 of FSMA and, if so, the seriousness of that misconduct;
- the extent to which the person could reasonably be expected to have known that they were performing a controlled function without approval;
- the length of the period during which the person performed a controlled function without approval;
- the appropriateness of taking action against the person instead of, or in addition to, taking action against a firm. In assessing this, we will consider the extent of the culpability of the firm for the person performing a controlled function without approval; and
- the person's position and responsibilities. The more senior the person that performs a controlled function without approval, the more seriously we are likely to view their behaviour, and therefore the more likely we are to take action against the person.

3.40 The circumstances in which we would expect to be satisfied that a person could reasonably be expected to have known that they were performing a controlled function without approval include:

- the person had previously performed a similar role at the same or another firm for which they had been approved;
- the person had previously applied for approval to perform the same or a similar controlled function;
- the person's seniority or experience was such that they could reasonably be expected to have known that they were performing a controlled function without approval; and
- the person's firm had clearly apportioned responsibilities so the person's role and the responsibilities associated with it were clear.

How we will determine the level of penalty

3.41 We recently published our new policy for determining the level of a penalty (see PS10/3: *Enforcement financial penalties*). This policy is set out in DEPP 6.5 to DEPP 6.5D, and is divided into cases against firms, non-market abuse cases against individuals, and market abuse cases against individuals. The new penalty-setting policy consists of five steps:

Step 1 we will seek to deprive a person of the financial benefit derived directly from the breach (which may include the profit made or loss avoided) where it is practicable to quantify this.

Step 2 we determine a figure that reflects the seriousness of the breach. This figure is based on a percentage of the individual's relevant income, with the percentage varying between 0% and 40%, depending on the level of seriousness of the breach. For level 1 breaches, the relevant percentage is 0%, for level 2 breaches it is 10%, for level 3 breaches it is 20%, for level 4 breaches it is 30%, and for level 5 breaches it is 40%. The relevant level is determined having taken into account relevant factors, which will usually fall into the following four categories:

1. factors relating to the impact of the breach;
2. factors relating to the nature of the breach;
3. factors tending to show whether the breach was deliberate; and
4. factors tending to show whether the breach was reckless.

Step 3 we may amend the Step 2 figure to take into account aggravating and mitigating factors.

Step 4 we may increase the Step 3 figure if we consider it insufficient to deter the person who committed the breach, or others, from committing further or similar breaches.

Step 5 we will apply the settlement discount scheme set out in DEPP 6.7.

3.42 As this penalty-setting policy applies to all types of cases, we consider that, to have a consistent, single approach, the policy for individuals (set out in DEPP 6.5B) should apply when we determine the appropriate level of penalty to impose on a person who has performed a controlled function without approval.

3.43 In order for the penalty-setting policy to fully cover the non-approved persons penalty power, we propose making changes to Steps 2 and 3 of the penalty-setting policy for individuals.

3.44 At Step 2 we propose to include the following additional factors relating to the nature of a breach by an individual:

- For a contravention of section 63A of FSMA, whether the individual's only misconduct was to perform a controlled function without approval. This will also be a factor that is likely to be considered a level 1, 2 or 3 factor.

- For a contravention of section 63A of FSMA, the extent to which the individual could reasonably be expected to have known that they were performing a controlled function without approval.

3.45 At Step 3 we propose to include the additional factors:

- For a contravention of section 63A of FSMA, whether the individual performed controlled functions without approval and, while doing so, committed misconduct for which, if they had been an approved person, we would have been empowered to take action pursuant to section 66 of FSMA.
- For a contravention of section 63A of FSMA, whether the individual has previously withdrawn an application for the same controlled function or has had such an application turned down by us.

Decision maker

3.46 We consider that the RDC should be the decision maker for giving warning notices and decision notices for cases where a penalty is imposed on a person that has performed a controlled function without approval. This is consistent with the fact that the RDC decides the level of other penalties.

Q8: Do you have any comments about our proposed policy for the non-approved persons penalty power?

The short selling penalty power

3.47 Sections 131E and 131F of FSMA, as amended by the Act, provide that we have the power to require a person to provide information and documents that we reasonably require for the purpose of determining whether a person, or a person connected to them, has contravened any provision of short selling rules.

3.48 Section 131G of FSMA, as amended by the Act, provides that we have the power to impose a financial penalty or public censure on a person that contravenes any provision of short selling rules or any requirement imposed under sections 131E or 131F, or on a person who was knowingly concerned in the contravention.

The circumstances in which we will use the short selling penalty power to impose a penalty

3.49 DEPP 6.2 sets out our policy for deciding whether to take action to impose a financial penalty or public censure. We propose to adopt this policy for the short selling penalty power as we consider this will ensure consistency in how we approach these penalties. This does not require any changes to DEPP.

How we will determine the level of penalty

3.50 We recently published our new five-step policy for determining the level of a penalty (see PS10/3: *Enforcement financial penalties*). This policy is set out in DEPP 6.5 to DEPP 6.5D, and is divided into cases against firms, non-market abuse cases against individuals, and market abuse cases against individuals. As this penalty-setting policy applies to all types of cases, we consider that, to have a consistent, single approach to setting penalties, it should also apply when we determine the appropriate level of penalty to impose when we use the short selling penalty power. This does not require any changes to DEPP.

Decision maker

3.51 We consider that the RDC should be the decision maker for giving warning notices and decision notices for cases where we use the short selling penalty power. This is consistent with the fact that the RDC decides the level of other penalties.

Q9: Do you have any comments about our proposed policy for the short selling penalty power?

Cost benefit analysis

3.52 A cost benefit analysis (CBA) assesses the economic costs and benefits of a proposed policy. When proposing new rules, we are obliged under section 155 of FSMA to publish a CBA, unless we consider that they will give rise to no costs or an increase in costs of minimal significance. Although we have no statutory obligation to do so, we may also publish a CBA when proposing new guidance. We have previously confirmed[4] that we will publish a CBA in the following circumstances:

- where we consider our proposed guidance may materially impact market structures;
- where it may change the behaviours of firms in a way that is not already accepted in the market; and
- where the guidance is not reasonably predictable from the Principle, rules or other guidance (without it being a new requirement).

3.53 As our enforcement policy seeks to increase compliance through greater deterrence, its aim is to change behaviour in the market. As a result, we have in the past provided a CBA when we have made substantive changes to our enforcement policy.

3.54 The CBA is an estimate of the costs and an analysis of the benefits that will arise from the proposals. It is a statement of the differences between the baseline (which we will usually consider to be the current position) and the position that will arise if we implement the proposals.

4 In our April 2007 publication '*Principles-based regulation: focusing on outcomes that matter*'

3.55 In relation to the new enforcement powers, the baseline cannot be the current position (i.e. no policy), given that we have a legal duty to publish a Policy Statement for our penalty and suspension powers (at sections 63C, 69, 131J and 210 of FSMA). FSMA also requires each of these policies to have regard to certain factors. For example, under section 69(2) of FSMA, our policy for determining the amount of a penalty or the length of a suspension period imposed on an approved person must include having regard to:

(a) the seriousness of the misconduct;

(b) the extent to which the misconduct was deliberate or reckless; and

(c) whether the person is an individual.

For the purposes of the CBA, we believe that the proposed policy should be compared with a baseline, whereby we provide either more or less detail, or we restrain our discretion more or less in future.

3.56 This CBA covers:

- the proposed policy for the suspension power;
- the proposed policy for the non-approved persons penalty power; and
- the proposed policy for the short selling penalty power.

Benefits

3.57 Guidance on the approach we will take in enforcing our rules and other regulatory requirements provides additional legal certainty, as well as clarity and transparency for stakeholders. The key benefit flowing from this is increased deterrence and as a result greater compliance. Where breaches of our rules are premeditated, a clearer view of the likely consequences will enable firms and individuals to factor this into their decision making when considering the likely costs and benefits to them of any particular action. Where breaches are not premeditated, greater clarity will reduce the likelihood of errors.

3.58 With regard to the suspension power, the proposed policy provides clarity and transparency, as it indicates how we will decide whether to impose a suspension and how long the suspension period should be. The benefit of our proposed approach for using the power is that it provides us with the flexibility to consider, in any given future case, whether suspension or penalty, or a combination of both, may be most effective in delivering maximum deterrence in a proportionate manner. In contrast, the alternative approach considered – imposing a suspension only when a penalty is an insufficient deterrent – may unduly restrict us in future from using the new power in the most cost efficient and effective way, and so may not achieve adequate deterrence and may not lead to the most proportionate outcome. For example, suspension may in some cases be better targeted at the cause of the problem, addressing the relevant misconduct directly, whereas penalties are often more of an indirect sanction.

3.59 For the non-approved persons penalty power and the short selling penalty power we propose to apply our current approach to deciding whether to impose a penalty, and the amount of that penalty, with some necessary amendments. This has the benefit of ensuring we have a consistent, single approach to setting penalties, and so extends the benefits of clarity, transparency and greater deterrence associated with the existing penalties regime.

Costs

3.60 The costs we anticipate as a result of the proposed policies are mainly the costs to firms of providing evidence to us for a specific future enforcement action. Firms and individuals may face lower costs if policies were adopted that meant we would consider fewer factors.

3.61 There are also other costs to us and to firms in terms of staff training with regard to the new enforcement powers and our enforcement policy. We have provided an estimate of these costs for us below, and we consider these are not likely to be material for firms (see below).

3.62 We do not expect our total number of enforcement cases to increase as a direct result of the new enforcement powers. Therefore, any costs that would have been incurred by stakeholders or us without the new powers are not considered in this CBA.

Costs to the FSA

3.63 Some internal training will be needed to ensure that our staff are familiar with the policy for the new enforcement powers. This applies to staff in the Regulatory Decisions Committee (RDC) and the Enforcement and Financial Crime Division. We estimate that there are approximately 300 members of staff directly affected by this proposal and that an average of one hour's training should be adequate to make staff aware of the changes. The one-off cost of this would be approximately £9,000.

3.64 There may also be some cost on a case-by-case basis in verifying cost data and other evidence provided by firms and individuals in enforcement cases. However, because we expect that the overall number of enforcement cases taken on by us remains unaffected by the new powers, these costs are met within existing budgets.

Suspension power

3.65 The costs of the proposed policy to authorised and approved persons are likely to be the costs of providing us with information to ascertain the likely impact of suspension. For approved persons, we will consider their expected lost earnings from not being able to carry out the suspended activity. Given that we will usually require information about their income when determining the level of appropriate penalty, we consider that providing this information will not usually be an additional cost.

3.66 Because we do not expect an increased overall number of enforcement cases as a result of the new powers, and income data would also usually need to be provided in existing cases, these costs are not additional.

3.67 We may require firms to provide us with evidence of:

i. expected lost revenue and profits from not being able to carry out the suspended activity;

ii. the cost of any measures they must undertake to comply with the suspension;

iii. potential economic costs – for example, the payment of salaries to employees who will not work during the suspension period; and

iv. the effect on other areas of their business.

3.68 The additional time required to provide an estimate of revenue and profits likely to be lost due to suspension could be taken straight from a firm's internal business plan.

3.69 Firms may have to provide estimates of the cost of measures they may need to take to comply with any suspension. It is not possible to estimate how much it would cost firms to provide such estimates in the absence of a specific case, because this will depend on the type and complexity of the business.

3.70 Firms will need to provide estimates of economic costs – for example, the payment of salaries to employees or other cost impacts (such as impacts on other areas of the business). It is not possible, in the absence of a specific case, to provide a useful estimate of how much it will cost to provide such estimates. This is because the cost of providing them will depend on the size and complexity of the business in question. However, we will consider such costs in specific future enforcement cases if they are likely to be material.

3.71 In addition, there will be some cost for legal and compliance teams, as they come to understand our policy for the suspension power. However, we expect these costs to be immaterial as we have incorporated the provisions of the Act into our existing enforcement policy framework as far as possible.

The non-approved persons penalty power and the short selling penalty power

3.72 Individuals and firms will face the same costs for supplying us with income information as they would have to for penalties imposed in any other case[5]. As we do not expect the total amount of enforcement cases we take per year to change as a result of the new powers, there will be no additional costs.

Compatibility statement

3.73 This section explains our reasons for concluding that our proposals for our new enforcement powers are compatible with our general duties under section 2 of FSMA and our regulatory objectives set out in Sections 3 to 6.

5 The CBA for our penalty policy is set out in our Consultation Paper: CP09/19.

Compatibility with our statutory objectives

3.74 Our statutory objectives are set out in section 2(2) of FSMA as amended by the Act. All of them, except the new financial stability objective, are relevant to our proposals.

Securing the appropriate degree of protection for consumers

3.75 The effective and appropriate use of our investigation and enforcement powers plays an important part in the pursuit of our regulatory objectives, including the consumer protection objective. We propose to use the suspension power when we consider suspension to be a more effective and persuasive deterrent than a financial penalty alone. We believe that the greater deterrence provided by the use of the suspension power will benefit consumers.

3.76 Our proposal to apply the new penalties framework to cases where the new penalty powers are used means that the persons who are subject to enforcement action will have a clear idea of the likely level of fine for their misconduct. As we believe the penalties framework will result in levels of penalties that are a clear deterrent, we consider that consumers will benefit from this approach.

Maintaining confidence in the financial system

3.77 As we will use the suspension power where we consider suspension to be a more effective and persuasive deterrent than a financial penalty alone, this should increase our effectiveness in deterring misconduct and should enhance confidence in the financial system.

3.78 The high level of penalties likely to result from using the new penalties framework, which we propose should extend to the use of the new penalty powers, should increase deterrence and therefore increase confidence in the financial system.

Reducing financial crime

3.79 We anticipate that our proposals for the suspension power should increase our effectiveness in deterring misconduct, leading to a reduction in financial crime.

Compatibility with the Principles of Good Regulation

3.80 Section 2(3) of FSMA requires that, in carrying out our general functions, we must have regard to a number of specific matters. Of these, the following matters are particularly relevant to our proposals.

The principle that a burden or restriction should be proportionate to the benefits

3.81 While the proposed policy for the suspension power may require authorised or approved persons to provide us with information about the likely impact of the suspension, we consider this to be proportionate to the benefit of being able to properly determine a suspension period, which is proportionate to the misconduct committed and the impact of the suspension on the person, and is also a sufficient deterrent.

The need to minimise the adverse effects on competition that may arise from anything done in the discharge of those functions

3.82 We consider that the proposed changes are largely procedural and should not therefore have material adverse effects on competition, as they will not adversely affect compliant firms and individuals. However, use of the suspension power may reduce the number of competitors in a market, which could affect consumers. We will need to take this into account in considering the proportionality and impact of suspending a firm for a certain period of time.

4 Financial stability information-gathering power

4.1 This chapter describes our policy on the use of the financial stability information-gathering power in sections 165A and 169A of the Act. The statement of policy will be contained in the new Handbook module, the Financial Stability and Market Confidence sourcebook (FINMAR).

4.2 The Act has given us a financial stability objective: 'contributing to the protection and enhancement of the stability of the UK financial system'. The Act has also given us a new financial stability information-gathering power (the power), which applies to authorised and unauthorised persons and will assist us in identifying threats to financial stability, including developing threats and those arising from unauthorised entities' activities.

4.3 In March 2009 we published FSA Discussion Paper DP09/2 A regulatory response to the global banking crisis, which observed that 'As part of [proposed new arrangements to deal with unregulated activities] regulators need – as a first step – to have information gathering powers to enable them to collect information from unregulated financial firms when their activities present risk to financial stability'.[6] The new power is part of Parliament's response to this need. It supplements our existing powers and duties, which are contained in Part XI of FSMA and section 250 of the Banking Act 2009.

Using the power in practice

4.4 The financial stability information-gathering power will assist us in identifying, assessing and mitigating threats to financial stability arising from current and future types of unregulated business.

4.5 This would include assisting us in determining what action to take to mitigate the risks run by authorised firms as a result of dealing with unregulated sectors. Mitigating actions could include, for example, ensuring firms' systems and controls are adequate, limiting exposures to these sectors and ensuring appropriate levels of capital are in place for the risks identified.

6 See paragraph 6.22 of FSA Discussion Paper 09/2: http://www.fsa.gov.uk/pubs/discussion/dp09_02.pdf

4.6 The power would also allow us to gather information to provide to the Treasury concerning potential extensions to the regulatory perimeter. This would assist the Treasury in considering whether to extend the scope of regulation based on sound evidence. This approach is supported by industry feedback to DP09/2 and the Treasury's white paper, Reforming Financial Markets.[7]

Scope of the power

4.7 We may use this power when information or documents are, or may be, relevant to UK financial stability. The point at which an entity or instrument becomes relevant to financial stability will depend on, among other things: the size and liquidity of the relevant market; the proportion of the market the entity's investments account for; the interconnectedness of the entity to other market players; and the volatility of the market. Activities that may not be considered a risk to financial stability during 'normal' market conditions may, in fact, create such risks if the markets they relate to are under stress or become unusually volatile. Also, activities that may not pose risks to financial stability when undertaken on a small scale by a single participant may become relevant to financial stability if they are practised widely.

4.8 The policy set out in FINMAR gives examples of types of persons within the scope of the power. Further examples of the types of entities that may be covered are given below.

- The reference to 'a person who has a legal or beneficial interest in any of the assets of a relevant investment fund, or a person who is responsible for the management of a relevant investment fund' could include: a vehicle for collective investment (whether or not it is regulated); vehicles often referred to as 'hedge funds' and their managers; and structured investment vehicles (SIVs) and off-balance sheet vehicles, among others.[8]
  - One example could be SIVs that engage in significant amounts of maturity transformation in credit markets by using short-term borrowing in the capital markets to fund long-term lending. These entities were performing bank-like functions but were not regulated as banks. The lack of capital and liquidity regulation and of access to central bank funding meant that they were particularly vulnerable to cash flow insolvency when wholesale markets dried up. The failure of the SIVs threatened authorised firms that held debt instruments issued by them or that had provided liquidity facilities to them. The failure of some SIVs also posed risks for the originators of the assets – who wished to access the funding provided through the SIVs and the wider economy – through the loss of an increasingly significant source of finance. US money market funds were also significant holders of SIV commercial paper, which meant that their failure also caused potential risks for retail and other investors in those money market funds.

7 The FSA's Feedback Statement 09/3 can be found here: http://www.fsa.gov.uk/pubs/discussion/fs09_03.pdf. Written responses to Reforming Financial Markets can be found here: http://www.hm-treasury.gov.uk/rfm_responses.htm

8 The reference to 'beneficial interests' could relate, for example, to the trustee of an investment fund whose underlying assets are held by a CREST nominee. As a result the trustee would not have legal ownership of those assets.

– Hedge funds and their prime brokers or counterparties provide another example. We already regulate hedge fund managers based in the UK, and we have a constructive and voluntary dialogue with many of the underlying funds they manage. We also survey prime brokers in order to monitor exposures of offshore hedge funds, and the new power is not intended to replace our current information gathering from these sources. However, there may be instances where we need to gather information for financial stability purposes more quickly or directly than our current dialogue permits. In addition, if a large number of hedge funds (which trade in a number of Markets in Financial Instruments Directive (MiFID) instruments) are serviced by a single prime broker, the collapse of this critical prime broker may have a significant knock-on impact on the hedge funds it provides services to, which in turn may have a systemic impact on the markets or investors that are active in them. The prime broker may not know if it is the sole broker for any of these funds and, if so, how many or what the positions or exposures of those funds are. We could therefore use the power in relation to a number of entities such as hedge funds to gauge the concentration risk that may exist.

- The power also covers service providers to authorised persons. Financial firms increasingly rely on outsourcing service providers to perform core functions, and over time a large number of firms may increasingly come to rely on a single service provider for critical processes. The power could enable us to assess whether there is any concentration risk, in terms of the number of firms using the same provider or geographical location, which may impact financial stability. We would only seek information relating to the service that is being provided, and not on wider dealings with the authorised person.

- Large scale proprietary traders are also within the scope of the power. This category covers a wide range of actors whose trading volumes and practices could create a risk to financial stability. It includes overseas persons trading large volumes on UK markets using the overseas persons exclusion in the Regulated Activities Order 2001 or proprietary investors who may suddenly unwind large positions. It also includes, for example, large unregulated oil derivatives traders associated with energy companies; sovereign wealth funds and family offices undertaking wealth management activities. Individually or in collaboration it is possible that these activities of such unregulated large market players could pose a risk to financial stability.

4.9 The history of financial crises demonstrates that each is caused by a different combination of circumstances. As a result, it is not necessarily possible to look at the last crisis and identify the likely source of a future financial crisis. For this reason we cannot describe a concrete list of entities which, now or in future, will create risks to UK financial stability, and the above examples are therefore illustrative and not comprehensive.

4.10 Overseas regulators may ask us to use the power to impose information requirements on entities when the risk is to financial stability in the overseas regulator's jurisdiction. When deciding how to respond to such a request, we would

take into account whether or not the overseas regulator is empowered to give corresponding assistance to the UK authorities. We retain the discretion to seek costs from the overseas regulator, although under current practice with existing powers costs are not generally sought in such circumstances. We may choose to not exercise the power unless the overseas regulator undertakes to make such contribution towards the cost of the exercise as we consider appropriate.

Types of information requirement

4.11 Some information requirements may be highly specific in nature; others may be broader or higher level. For example, with regard to service providers, we may ask for the names of the firms for which services are provided; risk indicators such as the number of IT incidents, or operational risk loss data; or we may ask to see the business continuity plan for a firm's data centre in the event of a power cut. Having this information would enable us to assess whether there is any concentration risk both in terms of the number of firms using the same provider or geographical location, and the operational risks (poor processes, systems and practices) posed by the service providers that may impact the stability of authorised firms.

4.12 Alternatively, we may make a broad request for information relating to a trading strategy and its execution over time; or for a contract documenting a particular trade or a firm's intentions with regard to a particular trade that may be likely to take place.

Deciding to use the power

General

4.13 In deciding whether to impose a financial stability information requirement, the factors we propose to take into account include:

- The nature and extent of the risks to financial stability. This includes assessing the extent of the potential impact the risk may have. The point at which an entity or instrument becomes relevant to financial stability will depend on the size and liquidity of the relevant market; the proportion of that market which the entity's investments account for; the interconnectedness of the entity to other market players; the volatility of the market and other factors. DP09/2 states that "there is no doubt that the growth of activities, such as maturity transformation and leverage within unregulated vehicles such as ABCP conduits and SIVs contributed significantly to the credit expansion that sowed the seeds of the current crisis".[9] Our macroprudential function will improve the monitoring of system-wide risks, including the rapid growth of off-balance sheet or unregulated entities, and will help inform any decisions to impose financial stability information requirements.

9 See paragraph 6.4 of FSA Discussion Paper 09/2: http://www.fsa.gov.uk/pubs/discussion/dp09_02.pdf

- Whether the information is more readily available from another source, taking into account the likely time and cost implications of seeking information from that source. For example, if we were concerned about the activities of an unregulated entity with which a large number of our authorised firms are dealing, we may in principle be able to impose information requirements on all of those regulated firms in order to build up a (potentially incomplete) picture of the unregulated entity's overall position and its potential systemic impact. This may be costly for us and the firms involved, and it may therefore be more efficient to require the unregulated entity to provide the information directly.
- Whether the information may assist us in fulfilling our functions, for example if the information relates to the exercise of our statutory powers.

4.14 A decision to impose an information requirement would be taken by a member of our staff of the appropriate seniority level. We expect our approach to be broadly in line with our existing approach to imposing information requirements; generally this is likely to involve a Head of Department or above.

4.15 In relation to authorised persons, the financial stability information-gathering power overlaps to some extent with our existing information-gathering powers. In deciding which to use, we will consider which has the most appropriate scope, and which best describes the purpose of our request.

4.16 In deciding what to ask for, we would focus where possible on documents or information that already exist, rather than asking firms to generate new data or produce new documents.

Q10: Have we identified the right factors to take into account in deciding whether to use this power?

Verification of information or authentication of documents

4.17 We may require a person that is subject to an information requirement to provide verification of any information or authentication of any document given under the information requirement.

4.18 When deciding whether to require verification or authentication, we propose to take into account the circumstances of each case, including:

- the type of information or documents required and whether there is a particular need for the information to be accurate;
- the likely additional cost to the person providing the information or documents;
- the extent to which verification or authentication may improve the quality or reliability of the information or documents; and
- the nature of any previous communications between the person and the FSA.

4.19 A consideration of the nature of any previous communications would include whether we have any evidence of past dishonest conduct, and whether any previous communications between the firm and us has given us doubts about the honesty or competence of the firm.

Non-urgent procedure

4.20 We would give a person a notice in writing if we propose to impose an information requirement unless we are satisfied that information or documents are needed without delay. The notice would include the time period in which the person may make representations to us in respect of the proposal. We will take 28 days as a starting point for determining a reasonable period for representations, in line with our current warning notice procedure.

4.21 In determining whether the period for representations should differ from the 28 day period, the factors we propose to take into account include:

- the nature, type and number of documents likely to be required;
- the reasons for imposing the requirement;
- whether the person is likely to wish to seek legal advice;
- whether the person is an authorised person; and
- any cost implications for the person.

4.22 An authorised person may be more familiar with the procedure associated with information requests from us and may have compliance officers already engaged or in house. An unauthorised person may need more time if they have not previously had to comply with one of our information requirements or if they need to engage or instruct lawyers.

4.23 In our opinion, written representations are a less costly and more convenient way of receiving representations, and help us to gain a sufficient understanding of the views being expressed. If, in particular cases, oral representations would be a better approach, we would consider requests to make oral representations.

Q11: Do respondents agree with this approach to non-urgent cases?

Urgent procedure

4.24 The Act empowers us to impose a financial stability information gathering requirement without prior notice, if we determine that it is necessary for the information or documents be provided without delay.

4.25 We would determine whether to impose a requirement without prior notice based on the facts of each case. We propose to take into account the information before us, including:

- the nature and extent of the risks to financial stability and whether the risk appears to be increasing rapidly. This includes whether the risk is contained to particular aspects of UK financial stability, or whether there is a risk to overall financial stability or contagion across parts of the UK financial system. It also includes our assessment of whether the risk is about to crystallise;
- whether it is fair to impose the requirement without notice. This includes recognition of the cost to impose an urgent request, and of the inherent desirability of receiving representations before using this aspect of the power, balancing that with the risk to financial stability; and
- whether the information sought may lead to us acting promptly. For example, we may seek information to assist us in deciding whether to alter an authorised person's permission to mitigate a risk; we may write new rules to mitigate a risk or we may use other powers very urgently that are consistent with the need to impose a requirement without notice.

4.26 The requirement would come into effect immediately, but if firms would like the opportunity to make formal representations, they should contact us as early as possible to discuss this. We would act reasonably and proportionately in considering any request.

Q12: Have we outlined reasonable factors to take into account when considering whether to impose a requirement without delay?

Cost benefit analysis

4.27 We are not required to provide cost benefit analysis on proposed guidance.[10] In considering a particular information request, we would take into account our new financial stability objective and the burden on affected firms to help us decide whether a request should be made of an entity or class of entities. The requests to the firms would be carried out in a in a proportionate manner.

Compatibility statement

4.28 The proposals outlined in this chapter are compatible with our financial stability objective because the new power to gather information from unregulated entities materially improves our ability to identify potential risks to financial stability.

10 An estimate of the possible costs of the introduction of the power was published by the Treasury as part of their impact assessment for the Financial Services Bill in November 2009. The impact assessment can be found here: http://www.hm-treasury.gov.uk/d/fin_bill_ias.pdf

4.29 In presenting this proposal, we are satisfied that it is compatible with the general duties given to us in section 2 of FSMA, in particular to the principle that a burden or restriction should be proportionate to the expected benefits, and the need to use our resources in the most efficient and economic way. This is because our proposed policy seeks to take into account the burden that may be incurred by entities subject to an information requirement, and we would impose a higher burden only when we believe it would be justified in terms of a higher benefit.

4.30 We do not consider this proposal to have adverse effects on innovation or competition.

5 Compensation amendments

5.1 This chapter deals with those measures in the Act relating to the Financial Services Compensation Scheme (FSCS). It concerns circumstances where the FSCS acts on behalf of other compensation schemes, including a scheme anywhere in the world outside the UK; and makes amendments in relation to the FSCS's contribution to the Special Resolution Regime (SRR) costs.

5.2 Effective and credible compensation arrangements are an important part of depositor and consumer protection, financial stability and maintaining confidence in the financial system.

5.3 The FSCS is the UK's statutory fund of last resort for customers of authorised financial services firms. This means it can pay compensation if a firm is unable or likely to be unable to pay claims against it. The FSCS covers deposits, insurance policies, insurance broking (for business on or after 1 January 2005), investment business and home finance (for business on or after 31 October 2004). The rules covering compensation can be found in the Compensation Sourcebook (COMP) of the FSA Handbook.[11] The rules relating to the funding of the scheme are in section 6 the Fees manual (FEES 6).[12]

5.4 The Act makes two substantive proposals concerning the FSCS. Firstly the Act identifies a role for FSCS to act on behalf of other compensation schemes, including a scheme anywhere in the world outside the UK, where compensation is payable by that scheme.

5.5 At present the FSCS has a discretionary power to act in certain circumstances but not all. However, the Act will enable the Treasury to require the FSCS to act, and to require the FSCS to act in relation to a broader range of circumstances.[13] Without these new provisions there may be circumstances where the FSCS is not able to act on behalf of another compensation scheme to compensate customers of failed financial firms, in particular firms that are not authorised financial services firms

11 http://fsahandbook.info/FSA/html/handbook/COMP
12 http://fsahandbook.info/FSA/html/handbook/FEES
13 These new provisions will only come into effect when a Treasury order is made.

under FSMA. This could potentially result in those consumers experiencing problems in obtaining compensation, for example, because of delays in the other scheme making payments as a result of linguistic or administrative issues.

5.6 Section 224D of the Act provides for grounds on which the FSCS can decline to act on behalf of the other scheme. These include FSCS not being satisfied that it will be able to obtain the information and assistance it needs to act on behalf of the other scheme or FSCS not having received the funds needed to cover the expenses which it expects to incur in connection with its work on behalf of the other scheme.

5.7 There could be situations where the FSCS is unable to recoup management expenses for any initial work conducted by it on behalf of the other scheme. While we do not anticipate these expenses will be significant and consider the likelihood of this happening to be low, we propose making rule changes to FEES 6 to allow for these costs to be recouped from FSCS levy payers[14] should they arise. It should be noted that under the new rules the FSCS should have tried its best to obtain reimbursement of the expenses from the relevant scheme before it imposes levies on FSCS levy payers.

5.8 The rules will allow FSCS discretion as to how these costs are allocated amongst participant firms.[15]

Q13: Do you agree with our proposal to amend FEES 6 to allow for the management expenses to be recouped from FSCS levy payers if FSCS has failed to obtain reimbursement of these expenses from the relevant scheme?

5.9 The Act also makes amendments to the Special Resolution Regime (SRR) established under the Banking Act 2009, in particular the contribution to the costs of SRR by FSCS. The change is to allow for the costs relating to the time value of money to be recouped, which is not envisaged in the current clause in the Banking Act.

5.10 We will amend guidance in our FEES 6 manual to clarify that section 214B or section 214D costs are not classed as management expenses and to extend the definition of compensation costs to include section 214B or section 214D costs. We are also taking the opportunity to amend the definition of compensation costs to reflect section 61 of the Banking Act 2009.

5.11 A draft instrument is attached as Appendix 4.

14 FSCS levy payers would be the only source available to recover these funds.

15 These Handbook changes will only be made once the relevant provisions in the Act have been commenced by Treasury Order.

List of consultation questions

Chapter 2

Q1: Do you agree with our proposal to re-cast the current disclosure obligations, contained in the Code of Market Conduct, as new FSA rules in the Financial Stability and Market Confidence sourcebook of the FSA Handbook?

Q2: Do you agree that it is appropriate to narrow the scope of the rights issue disclosure obligation as proposed?

Q3: Do you have any comments on our proposal to maintain the disclosure requirements, including the thresholds, unchanged?

Q4: Do you agree with the approach to calculation of net short positions, including changes of position, we propose? Are there any additional issues about which you believe we should make rules or provide guidance?

Q5: Do you agree with the approach to netting of net short positions, that we propose? Are there any additional issues about which you believe we should make rules or provide guidance?

Q6: Do you have any comments on our proposals concerning who is covered by and who is exempt from the disclosure obligations?

Chapter 3

Q7: Do you have any comments about our proposed policy for the suspension power?

Q8: Do you have any comments about our proposed policy for the non-approved persons penalty power?

Q9: Do you have any comments about our proposed policy for the short selling penalty power?

Chapter 4

Q10: Have we identified the right factors to take into account in deciding whether to use this power?

Q11: Do respondents agree with this approach to non-urgent cases?

Q12: Have we outlined reasonable factors to take into account when considering whether to impose a requirement without delay?

Chapter 5

Q13: Do you agree with our proposal to amend FEES 6 to allow for the management expenses to be recouped from FSCS levy payers if FSCS has failed to obtain reimbursement of these expenses from the relevant scheme?

Enforcement powers (Financial Services Act 2010)

Instrument 2010

ENFORCEMENT POWERS (FINANCIAL SERVICES ACT 2010) INSTRUMENT 2010

Powers exercised

A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000:

(1) section 63C(1) (Statement of policy);
(2) section 69(1) (Statement of policy);
(3) section 131J(1) (Statement of policy);
(4) section 157(1) (Guidance);
(5) section 210(1) (Statements of policy); and
(6) section 395(5) (The Authority's procedures).

Commencement

B. This instrument comes into force on [6 August 2010].

Amendments to the Handbook

C. The Glossary is amended in accordance with Annex A to this instrument.

D. The Decision Procedure and Penalties manual (DEPP) is amended in accordance with Annex B to this instrument.

Amendments to the Enforcement Guide

E. The Enforcement Guide (EG) is amended in accordance with Annex C to this instrument.

Citation

F. This instrument may be cited as the Enforcement Powers (Financial Services Act 2010) Instrument 2010.

By order of the Board
[22 July 2010]

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text.

breach in *DEPP*:

…

(4) behaviour amounting to *market abuse*, or to *requiring or encouraging market abuse*, in respect of which the *FSA* takes action pursuant to section 123 (Power to impose penalties in cases of market abuse) of the *Act*; ~~or~~

(5) a contravention of any directly applicable *EU* regulation made under ~~MiFID~~ *MiFID*; or

(6) a contravention in respect of which the *FSA* is empowered to take action pursuant to section 131G (Power to impose penalties or issue censures for breaches relating to the short-selling rules) of the *Act*.

Annex B

Amendments to the Decision Procedure and Penalties manual (DEPP)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

1.1 Application and Purpose

Application

1.1.1 G This manual (*DEPP*) is relevant to *firms, approved persons* and other *persons*, whether or not they are regulated by the *FSA*. It sets out:

…

(2) the *FSA's* policy with respect to the imposition and amount of penalties under the *Act* (see *DEPP* 6);

(2A) the *FSA's* policy with respect to the imposition of suspensions or restrictions, and the period for which those suspensions or restrictions are to have effect, under the *Act* (see *DEPP* 6A);

…

Purpose

1.1.2 G The purpose of *DEPP* is to satisfy the requirements of sections 63C(1), 69(1), 93(1), 124(1), 131J(1), 169(7), 210(1) and 395 of the *Act* that the *FSA* publish the statements of procedure or policy referred to in *DEPP* 1.1.1G.

…

2 Annex 1G Warning notices and decision notices under the Act and certain other enactments

…

Section of the Act	Description	Handbook reference	Decision maker
...			
63(3)/(4)	when the *FSA* is proposing or deciding to withdraw approval from an *approved person**		*RDC*

63B(1)/(3)	when the *FSA* is proposing or deciding to impose a penalty on a *person* under section 63A*		*RDC*
…			
126(1)/ 127(1)	when the *FSA* is proposing or deciding to impose a sanction for *market abuse**		*RDC*
131H(1)/(4)	when the *FSA* is proposing or deciding to take action against a *person* under section 131G*		*RDC*
…			
207(1)/ 208(1)	When, in respect of an *authorised person*, the *FSA* is proposing or deciding to publish a statement ~~in respect of an *authorised person*~~ (under section 205) or impose a financial penalty ~~on an *authorised person*~~ (under section 206) or suspend a *permission* or impose a restriction in relation to the carrying on of a *regulated activity* (under section 206A)*		*RDC*
…			

6.1 Introduction

6.1.1 G *DEPP* 6 includes the *FSA's* statement of policy with respect to the imposition and amount of penalties under the *Act*, as required by sections 63C(1), 69(1), 93(1), 124(1), 131J(1) and 210(1) of the *Act*.

…

6.2 Deciding whether to take action

…

6.2.9 G Where disciplinary action is taken against an *approved person* the onus will be on the *FSA* to show that the *approved person* has been guilty of misconduct.

Action against persons that perform a controlled function without approval under section 63A of the Act

6.2.9A G In addition to the general factors outlined in *DEPP* 6.2.1G, there are some additional considerations that the *FSA* will have regard to when deciding whether to take action against a *person* that performs a *controlled function* without approval contrary to section 63A of the *Act*.

(1) The conduct of the *person*. The *FSA* will take into consideration whether, if the *person* had been approved, his actions would have amounted to misconduct for which the *FSA* could take action pursuant to section 66 of the *Act* and, if so, the seriousness of that misconduct.

(2) The extent to which the *person* could reasonably be expected to have known that he was performing a *controlled function* without approval. The circumstances in which the *FSA* would expect to be satisfied that a *person* could reasonably be expected to have known that he was performing a *controlled function* without approval include:

(a) the *person* had previously performed a similar role at the same or another *firm* for which he had been approved;

(b) the *person* had previously applied for approval to perform the same or a similar *controlled function*;

(c) the *person's* seniority or experience was such that he could reasonably be expected to have known that he was performing a *controlled function* without approval; and

(d) the *person's firm* had clearly apportioned responsibilities so the *person's* role, and the responsibilities associated with it, were clear.

(3) The length of the period during which the *person* performed a *controlled function* without approval.

(4) Whether the *person* is an individual.

(5) The appropriateness of taking action against the *person* instead of, or in addition to, taking action against an *authorised person*. In assessing this, the *FSA* will take into consideration the extent of the culpability of an *authorised person* for the *person* performing a *controlled function* without approval.

(6) The *person's* position and responsibilities. The more senior the *person* that performs a *controlled function* without approval, the more seriously the *FSA* is likely to view his behaviour, and therefore the more likely it is to take action against the *person*.

…

6.5B The five steps for penalties imposed on individuals in non-market abuse cases

…

Step 2 – the seriousness of the *breach*

…

6.5B.2 G …

(9) Factors relating to the nature of a *breach* by an individual include:

…

(n) whether the individual took any steps to comply with *FSA rules*, and the adequacy of those steps; ~~and~~

(o) in the context of contraventions of Part VI of the *Act*, the extent to which the *behaviour* which constitutes the contravention departs from current market practice;

(p) in relation to a contravention of section 63A of the *Act*, whether the individual's only misconduct was to perform a *controlled function* without approval; and

(q) in relation to a contravention of section 63A of the *Act*, the extent to which the individual could reasonably be expected to have known that he was performing a *controlled function* without approval. The circumstances in which the *FSA* would expect to be satisfied that a *person* could reasonably be expected to have known that he was performing a *controlled function* without approval include:

(i) the *person* had previously performed a similar role at the same or another *firm* for which he had been approved;

(ii) the *person* had previously applied for approval to perform the same or a similar *controlled function*;

(iii) the *person's* seniority or experience was such that he could reasonably be expected to have known that he was performing a *controlled function* without approval; and

(iv) the *person's firm* had clearly apportioned responsibilities so the *person's* role, and the responsibilities associated with it, were clear.

…

(13) Factors which are likely to be considered 'level 1 factors', 'level 2 factors' or 'level 3 factors' include:

…

(c) there was no, or limited, actual or potential effect on the orderliness of, or confidence in, markets as a result of the *breach*; ~~and~~

(d) the *breach* was committed negligently or inadvertently; and

(e) in relation to a contravention of section 63A of the *Act*, the individual's only misconduct was to perform a controlled function without approval.

Step 3 – mitigating and aggravating factors

6.5B.3 G …

(2) The following list of factors may have the effect of aggravating or mitigating the *breach*:

…

(l) whether the *FSA* publicly called for an improvement in standards in relation to the behaviour constituting the *breach* or similar behaviour before or during the occurrence of the *breach*; ~~and~~

(m) whether the individual agreed to undertake training subsequent to the *breach*;

(n) in relation to a contravention of section 63A of the *Act*, whether the individual performed *controlled functions* without approval and, while doing so, committed misconduct in respect of which, if the individual had been an *approved person*, the *FSA* would have been empowered to take action pursuant to section 66 of the *Act*; and

(o) in relation to a contravention of section 63A of the *Act*, whether the *person* has previously withdrawn an application for the same *controlled function* or has had such an application turned down by the *FSA*.

…

Insert the following new chapter after DEPP 6. The text is not underlined.

6A The power to impose a suspension or restriction

6A.1 Introduction

6A.1.1 G *DEPP* 6A includes the *FSA's* statement of policy with respect to the imposition of suspensions or restrictions, and the period for which those suspensions or restrictions are to have effect, under the *Act*, as required by

sections 69(1) and 210(1) of the *Act*.

6A1.2 G For the purposes of *DEPP* 6A, "suspension" refers both to the suspension of any *permission* which an *authorised person* has to carry on a *regulated activity* (under section 206A of the *Act*), and the suspension of any approval of the performance by an *approved person* of any function to which the approval relates (under section 66 of the *Act*); and "restriction" refers both to limitations or other restrictions in relation to the carrying on of a *regulated activity* by an *authorised person* (under section 206A of the *Act*), and to limitations or other restrictions in relation to the performance by an *approved person* of any function to which any approval relates (under section 66 of the *Act*).

6A.1.3 G The power to impose a suspension or a restriction is a disciplinary measure which the *FSA* may use in addition to, or instead of, imposing a financial penalty or issuing a *public censure.* The principal purpose of imposing a suspension or a restriction is to promote high standards of regulatory and/or market conduct by deterring *persons* who have committed *breaches* from committing further *breaches*, helping to deter other *persons* from committing similar *breaches*, and demonstrating generally the benefits of compliant behaviour. Suspensions and restrictions are therefore tools that the *FSA* may employ to help it to achieve its *regulatory objectives*.

6A.2 Deciding whether to take action

6A.2.1 G The *FSA* will consider the full circumstances of each case and determine whether it is appropriate to impose a suspension or restriction. The *FSA* will usually make this decision at the same time as it determines whether or not to impose a financial penalty or a *public censure*.

6A2.2 G The *FSA* will take into account relevant factors in deciding whether it is appropriate to impose a suspension or restriction. These may include factors listed in *DEPP* 6.2. There may also be other factors, not listed in *DEPP* 6.2, that are relevant.

6A.2.3 G The *FSA* will consider it appropriate to impose a suspension or restriction where it believes that such action will be a more effective and persuasive deterrent than the imposition of a financial penalty alone. This is likely to be the case where the *FSA* considers that direct and visible action in relation to a particular *breach* is necessary. Examples of circumstances where the *FSA* may consider it appropriate to impose a suspension or restriction include:

(1) where the *FSA* (or any *previous regulator*) has taken any previous disciplinary action resulting in adverse findings against the *person*;

(2) where the *FSA* has previously taken action in respect of similar *breaches* and has failed to improve industry standards;

(3) where the *person* has failed properly to carry out an agreed redress package or other agreed remedial measures;

(4) where the misconduct appears to be widespread across a number of individuals across a particular business area (suggesting a poor compliance culture);

(5) where the *person's* competitive position in the market has improved as a result of the *breach*;

(6) if, in accordance with *DEPP* 6.5D, the *FSA* considers that a proposed penalty would cause the subject of enforcement action serious financial hardship and that it is appropriate to reduce the proposed penalty.

6A.2.4 G The *FSA* expects usually to suspend or restrict a *person* from carrying out activities directly linked to the *breach*. However, in certain circumstances the *FSA* may also suspend or restrict a *person* from carrying out activities that are not directly linked to the *breach*, for example, where an *authorised person's* relevant business area no longer exists or has been restructured.

6A.3 Determining the appropriate length of the period of suspension or restriction

6A.3.1 G The *FSA* will consider all the relevant circumstances of a case when it determines the length of the period of suspension or restriction (if any) that is appropriate for the *breach* concerned, and is also a sufficient deterrent. Set out below is a list of factors that may be relevant for this purpose. The list is not exhaustive: not all of these factors may be applicable in a particular case, and there may be other factors, not listed, that are relevant.

6A.3.2 G The following factors may be relevant to determining the appropriate length of the period of suspension or restriction to be imposed on a *person* under the *Act*:

(1) Deterrence

When determining the appropriate length of the period of suspension or restriction, the *FSA* will have regard to the principal purpose for which it imposes sanctions, namely to promote high standards of regulatory and/or market conduct by deterring *persons* who have committed *breaches* from committing further *breaches* and helping to deter other *persons* from committing similar *breaches*, as well as demonstrating generally the benefits of compliant business.

(2) The seriousness of the *breach*

The *FSA* will have regard to the seriousness of the breach. In assessing this, it will consider the impact and nature of the *breach*, and whether it was committed deliberately or recklessly. Where the

breach was committed by an *authorised person*, relevant factors may include those listed in *DEPP* 6.5A.2G(6) to (9). Where the *breach* was committed by an *approved person*, relevant factors may include those listed in *DEPP* 6.5B.2G(8) to (11). There may also be other factors, not listed in these sections, that are relevant.

(3) Aggravating and mitigating factors

The *FSA* will have regard to factors that may aggravate or mitigate a *breach*. Where the *breach* was committed by an *authorised person*, relevant factors may include those listed in *DEPP* 6.5A.3G(2). Where the *breach* was committed by an *approved person*, relevant factors may include those listed in *DEPP* 6.5B.3G(2). There may also be other factors, not listed in these sections, that are relevant.

(4) The impact of suspension or restriction on the *person* in *breach*

The following considerations may be relevant to the assessment of the impact of suspension or restriction on an *authorised person*:

(a) the *authorised person's* expected lost revenue and profits from not being able to carry out the suspended or restricted activity;

(b) the cost of any measures the *authorised person* must undertake to comply with the suspension or restriction;

(c) potential economic costs, for example, the payment of salaries to employees who will not work during the period of suspension or restriction;

(d) the effect on other areas of the *authorised person's* business; and

(e) whether the suspension or restriction would cause the *authorised person* serious financial hardship.

The following considerations may be relevant to the assessment of the impact of suspension or restriction on an *approved person*:

(f) the *approved person's* expected lost earnings from not being able to carry out the suspended or restricted activity; and

(g) whether the suspension or restriction would cause the *approved person* serious financial hardship.

(5) The impact of suspension or restriction on *persons* other than the *person* in *breach*

The following considerations may be relevant to the assessment of the impact of suspension or restriction on *persons* other than the

person in *breach*:

(a) the extent to which *consumers* may suffer loss or inconvenience as a result of the suspension or restriction. For example, if it is difficult for *consumers* to switch to a competitor, a longer period of suspension or restriction is likely to have more impact; and

(b) the impact of the suspension or restriction on markets.

6A.3.3 G The *FSA* may delay the commencement of the period of suspension or restriction. In deciding whether this is appropriate, the *FSA* will take into account all the circumstances of a case. Considerations that may be relevant in respect of an *authorised person* include:

(1) the impact of the suspension or restriction on consumers;

(2) any practical measures the *authorised person* needs to take before the period of suspension or restriction begins, for example, changes to its systems and controls to enable it to stop or limit the activity in question;

(3) the impact of the suspension or restriction on other costs incurred by the *authorised person*, for example, cancelling suppliers or suspending employees.

6A.4 The interaction between the power to impose suspensions or restrictions and the power to impose penalties or public censures

6A.4.1 G The *FSA* recognises that the deterrent effect and impact on a *person* of a suspension or restriction, by itself or in combination with a financial penalty, could be greater than where only a financial penalty is imposed. The *FSA* will therefore consider the overall impact and deterrent effect of the sanctions it imposes when determining the level of penalty and the length of suspension or restriction.

6A.4.2 G The *FSA* expects usually to take the following approach in respect of the interaction between a suspension or restriction and a financial penalty or *public censure*:

(1) The *FSA* will determine which sanction, or combination of sanctions, is appropriate for the *breach*.

(2) If the *FSA*, following the approach set out in *DEPP* 6.2, considers it appropriate to impose a financial penalty, it will calculate the appropriate level of the financial penalty, following the approach set out in *DEPP* 6.5 *to DEPP* 6.5D.

(3) If the *FSA*, following the approach set out in *DEPP* 6A.2, considers it appropriate to impose a suspension or restriction, it will calculate

the appropriate length of the period of suspension or restriction, following the approach set out in *DEPP* 6A.3.

(4) Where the *FSA* considers it appropriate to impose both a financial penalty and a suspension or restriction, it will decide whether the combined impact on the *person* is likely to be disproportionate in respect to the *breach* and the deterrent effect of the sanctions.

(5) If the *FSA* considers the combined impact on the *person* is likely to be disproportionate, it will decide whether to reduce the period of suspension or restriction, the amount of the financial penalty or both, so that the combined impact of the sanctions is proportionate in relation to the *breach* and the deterrent effect of the sanctions. The *FSA* will decide which sanction to reduce after considering all the circumstances of the case.

(6) In deciding the final level of the financial penalty and the length of the period of suspension or restriction, the *FSA* will also take into account any representations by the *person* that the combined impact will cause them serious financial hardship. The *FSA* will take the approach set out in *DEPP* 6.5D in assessing this.

6A.4.3 G The *FSA* may depart from the approach set out in *DEPP* 6A.4.2G. For example, the *FSA* may at the outset consider that a financial penalty is the only appropriate sanction for a *breach* but, having determined the appropriate level of financial penalty, may consider it appropriate to reduce the amount of the financial penalty for serious financial hardship reasons. In such a situation, the *FSA* may consider it appropriate to impose a suspension or restriction even if the *FSA* at the outset did not consider such a sanction to be appropriate. The *FSA* will take into account whether the *person* would suffer serious financial hardship in deciding the length of the period of suspension or restriction, and may decide not to impose a suspension or restriction if it considers such action would result in serious financial hardship.

…

Schedule 4 Powers Exercised

Sch 4.1 G

The following powers and related provisions in or under the *Act* have been exercised by the *FSA* to make the statements of policy in *DEPP*:	
	Section 63C (Statement of policy)
	…
	Section 131J (Statement of policy)
	…

Annex C

Amendments to the Enforcement Guide (EG)

In this Annex, underlining indicates new text and striking through indicates deleted text.

1.2 In the areas set out below, the *Act* expressly requires the FSA to prepare and publish statements of policy or procedure on the exercise of its enforcement and investigation powers and in relation to the giving of *statutory notices* ~~.~~:

(1) section 63C requires the FSA to publish a statement of its policy on the imposition, and amount, of financial penalties on *persons* that perform a *controlled function* without approval;

~~(1)~~ (1A) sections 69 and 210 require the FSA to publish statements of policy on the imposition~~, and amount,~~ of financial penalties, suspensions or restrictions on *firms* and *approved persons*, the amount of financial penalties imposed, and the period for which suspensions or restrictions are to have effect;

…

(3) section 124 requires the FSA to publish a statement of its policy on the imposition, and amount, of financial penalties for *market abuse*;

(3A) section 131J requires the FSA to publish a statement of its policy on the imposition, and amount, of financial penalties imposed under s131G;

...

…

7.2 The FSA has the following powers to impose a financial penalty and to publish a *public censure*.

(1) It may publish a statement:

…

(e) where there has been *market abuse*, against a *person* under section 123 of the *Act*; ~~and~~

(ea) if a *person* has contravened any provision of short selling rules, or any requirement imposed on the *person* under section 131E or 131F, under section 131G of the *Act*; and

…

(2) It may impose a financial penalty:

…

(c) where there has been *market abuse*, on any *person*, under section 123 of the *Act*; ~~and~~

(ca) on a person who has contravened any provision of short selling rules, or any requirement imposed on the person under section 131E or 131F, or any person who was knowingly concerned in the contravention, under section 131G of the *Act*; and

…

…

Financial Stability and Market Confidence sourcebook

Instrument 2010

FINANCIAL STABILITY AND MARKET CONFIDENCE SOURCEBOOK INSTRUMENT 2010

Powers exercised

A. The Financial Services Authority makes this instrument in the exercise of:

(1) the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(a) section 119 (The code);
(b) section 121 (Codes: procedure);
(c) section 131B (Short selling rules);
(d) section 149 (Evidential provisions);
(e) section 156 (General supplementary powers);
(f) section 157(1) (Guidance); and

(2) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.

B. The rule-making powers referred to above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on 6 August 2010.

Making the Financial Stability and Market Confidence sourcebook (FINMAR)

D. The Financial Services Authority makes the rules and gives the guidance in Annex A to this instrument.

Amendments to the Handbook

E. The modules of the FSA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex B
Threshold Conditions (COND)	Annex C
Market Conduct sourcebook	Annex D

Notes

F. In Annex A to this instrument, the "notes" (indicated by "**Note:**") are included for the convenience of the reader but do not form part of the legislative text.

Citation

G. This instrument may be cited as the Financial Stability and Market Confidence Sourcebook Instrument 2010.

H. The sourcebook in Annex A to this instrument (including its schedules) may be cited as the Financial Stability and Market Confidence sourcebook (or FINMAR).

By order of the Board
[*date*]

Annex A

Financial Stability and Market Confidence sourcebook (FINMAR)

In this Annex, all the text is new and is not underlined, except where otherwise stated.

1 Gathering financial stability information

1.1 Application, purpose and scope

Application

1.1.1 G *FINMAR* 1 is relevant to *authorised persons* and *unauthorised persons*, in particular *persons* whose activities are or may be relevant to the stability of one or more aspects of a *relevant financial system*.

Purpose

1.1.2 G (1) Section 165B(6) (Statement of policy) of the *Act* requires the *FSA* to prepare and publish a statement of policy on the *financial stability information power*. The purpose of *FINMAR* 1 is to set out the *FSA's* statement of policy on the exercise of the *financial stability information power* and the *overseas financial stability information power* contained in sections 165A and 169A of the *Act*.

(2) The Treasury has approved this statement of policy in accordance with section 165B(7) of the *Act*.

1.1.3 G Determining whether to impose a *financial stability information requirement* involves different considerations from the exercise of other *FSA* powers. The *guidance* in this chapter relates only to the imposition of those requirements.

Scope of the powers

1.1.4 G The *financial stability information power* and the *overseas financial stability information power* are exercisable in relation to the categories of *person* set out in section 165A(2) of the *Act* (interpreted in accordance with the rest of that section).

1.1.5  Table: section 165A(2) of the Act

Section 165A of the *Act* applies to:	
(a)	a person who has a legal or beneficial interest in any of the assets of a relevant investment fund;
(b)	a person who is responsible for the management of a relevant investment fund;

	investment fund;
(c)	a person (a "service provider") who provides any service to an authorised person;
(d)	a person prescribed by an order made by the Treasury or any person of a description prescribed by such an order (and see also section 165C)[1];
(e)	a person who is connected with a person to whom this section applies as a result of any of the above paragraphs.

1.1.6 G The *FSA* may impose a *financial stability information requirement* on a *person* within the categories set out in *FINMAR* 1.1.5G only to the extent that it considers that the information or document is or might be relevant to the stability of one or more aspects of the *UK financial system*. The *persons* within these categories may include:

(1) a vehicle for collective investment, whether or not it is regulated, (including vehicles often referred to as "hedge funds" and "structured investment vehicles" or off-balance sheet vehicles used for investment) and its managers;

(2) a provider of a service to an *authorised person*, such as a software supplier or the provider of a liquidity facility, where the risk to the stability of one or more aspects of the *UK financial system* relates to the provision of the service;

(3) a large scale proprietary trader or investor who trades large volumes of *financial instruments* that are traded on *UK regulated markets* or *UK MTFs*, for example *overseas* corporate entities; and

(4) a *person* who manages investments for a single family (whether or not the investments are held within a trust), for example a family office.

1.2 Financial stability information powers

Introduction

1.2.1 G The *FSA* has a *regulatory objective* of contributing to the protection and enhancement of *UK* financial stability. Section 250 of the Banking Act 2009 imposes a duty on the *FSA* to collect certain information that it thinks is, or may be, relevant to the stability of individual financial institutions or to one or more aspects of the *UK financial system*.

1.2.2 G Some information relevant to *UK* financial stability will be accessible to the *FSA*:

[1] As of 26 April 2010 no order has been made under this section.

(1) through *authorised persons'* regular reports to the *FSA*; or

(2) from other *UK* or international authorities.

1.2.3 G The *FSA* may use the *financial stability information power* to gather additional information relevant to *UK* financial stability. The information may relate to the exercise of the *FSA's* functions, or the *FSA* may collect the information in order to disclose it to another *person* or authority, for example the Bank of England or the Treasury. Information relevant to financial stability may be held by an *authorised person* or by an *unauthorised person*.

1.2.4 G When the *FSA* seeks additional information from an *authorised person* or an *unauthorised person* it may not in all cases be necessary to exercise statutory information-gathering powers. However, the *FSA* will use its statutory powers if it believes it is appropriate to do so and in urgent cases, it may be appropriate for the *FSA* to exercise these powers without delay.

Financial stability information power

1.2.5 G The *FSA* may use the *financial stability information power* to require a *person* to provide:

(1) specified information or documents; or

(2) information or documents of a specified description;

that the *FSA* considers are or may be relevant to the stability of the *UK financial system*.

[**Note:** Section 165A of the *Act*]

Overseas financial stability information power

1.2.6 G The *FSA* may exercise the *overseas financial stability information power* at the request of an *overseas regulator* to require a *person* to provide:

(1) specified information or documents; or

(2) information or documents of a specified description;

that the *FSA* considers are or may be relevant to the stability of a *relevant financial system* operating in the country or territory of the *overseas regulator*.

[**Note:** Section 169A of the *Act*]

1.2.7 G If the *overseas regulator* is a *competent authority* and the request relates to an obligation of the *FSA* under *EU* law, the *FSA* will take into account whether it is necessary to exercise the *overseas financial stability information power* to comply with that obligation.

1.2.8 G In deciding whether to exercise the *overseas financial stability information power*, the *FSA* may take into account in particular:

(1) whether corresponding assistance would be given to a *UK* regulatory authority in the country or territory of the *overseas regulator*; and

(2) whether it is otherwise appropriate in the public interest to give the assistance sought.

1.2.9 G The *FSA* may decide not to exercise the *overseas financial stability information power* unless the *overseas regulator* undertakes to make such contribution towards the cost to the *FSA* of its exercise as the *FSA* considers appropriate.

1.2.10 G *FINMAR* 1.2.8G and *FINMAR* 1.2.9G do not apply if the *FSA* considers that it must use the *overseas financial stability information power* to comply with an obligation upon the *FSA* under *EU* law.

1.3 Providing notice before imposing a financial stability information requirement

Giving notice

1.3.1 G The *FSA* will give a *person* a notice in writing if it proposes to impose a *financial stability information requirement* unless the *FSA* is satisfied that information or documents are required without delay. The notice will include:

(1) the reasons why the *FSA* proposes to impose the *financial stability information requirement*; and

(2) the time period in which the *person* may make representations to the *FSA* in respect of the proposal.

Right to make representations

1.3.2 G The notice referred to in *FINMAR* 1.3.1G will specify a reasonable period in which to make representations. In determining the period for representations the *FSA* will take into account:

(1) the nature, type and number of documents likely to be required;

(2) the reasons for imposing the requirement;

(3) whether the *person* is likely to wish to seek legal advice;

(4) whether the *person* is an *authorised person*;

(5) any cost implications for the *person*.

1.3.3 G The *FSA* will generally invite the recipient of a notice to make representations in writing to the address provided in the notice. The *FSA* will consider a request by a *person* to make oral representations and will take into account:

(1) whether oral representations would be likely to:

(a) improve the *FSA's* understanding of the representations;

(b) be more convenient or less costly than written representations; and

(c) assist the *FSA* in making a decision more quickly; and

(2) as in other cases, and in accordance with the Disability Discrimination Act 1995, any reason relating to the disability of the person which would mean that they could not otherwise have a fair hearing.

1.3.4 G Once the period for making representations has expired the *FSA* will determine within a reasonable period whether to impose the *financial stability information requirement*.

1.3.5 G If the *FSA* does not receive any representations during the period specified in the notice it will determine whether to impose the *financial stability information requirement* based on the information available to it.

1.4 Imposing a financial stability information requirement without prior notice

1.4.1 G If the *FSA* proposes to impose a *financial stability information requirement* and is satisfied that it is necessary for the information or documents covered by a *financial stability information requirement* to be provided or produced without delay, the *FSA* may impose the *financial stability information requirement* on a *person* without taking the steps described in *FINMAR* 1.3 (see section 165B (4) of the *Act*).

1.4.2 G The *FSA* will determine whether to impose a *financial stability information requirement* without prior notice based on the facts of each case and after taking into account the information before it concerning:

(1) the nature of the risk to financial stability and whether the risk appears to be increasing rapidly;

(2) the extent of the risk to financial stability;

(3) whether it is fair to impose the requirement without notice; and

(4) whether the information sought may lead to prompt action by the *FSA*.

1.4.3 G A *person* who receives a *financial stability information requirement* without prior notice should consider whether to contact the *FSA* concerning the requirement. The *person* should raise any proposal to make representations with the *FSA* at the earliest opportunity.

1.5 Imposing a requirement

Deciding to impose a requirement

1.5.1 G In deciding whether to impose a *financial stability information requirement* the *FSA* will:

(1) review the material before it;

(2) consider any representations received from the proposed recipient of the requirement; and

(3) take into account:

(a) the nature and extent of the risks to financial stability;

(b) whether the information is more readily available from another source, taking into account the likely time and cost implications of seeking information from that source;

(d) whether the information may assist the *FSA* in fulfilling its functions, for example if the information relates to the exercise of the *FSA's* statutory powers.

1.5.2 G A decision to impose the *financial stability information requirement* will be taken by a member of *FSA* staff at the appropriate level of seniority.

Scope of the requirement

1.5.3 G The information and documents specified will be appropriate for each case. They may be defined broadly, for example information relating to a trading strategy and its execution, or in a more limited way, for example a contract documenting a particular trade.

Notice of a financial stability information requirement

1.5.4 G The *FSA* will give a *person* notice in writing if it decides to impose a *financial stability information requirement*. The notice will describe the information and documents to which the requirement relates and include the *FSA's* reasons for imposing the requirement.

Requiring documents to be verified or authenticated

1.5.5 G The *FSA* may, where it is reasonable to do so, require a *person* subject to a *financial stability information requirement* to provide:

(1) verification of any information; or

(2) authentication of any document;

that the *person* provides to the *FSA* in accordance with that requirement.

1.5.6 G When deciding whether to require verification or authentication the *FSA* will take into account the circumstances of each case, including:

(1) the type of information or documents required and whether there is a particular need for the information to be exactly accurate;

(2) the likely additional cost to the *person* providing the information or documents;

(3) the extent to which verification or authentication may improve the quality or reliability of the information or documents; and

(4) the nature of any previous communications between the *person* and the *FSA*.

1.5.7 G The *FSA* may, where it is reasonable to do so, require the information or documents to be verified or authenticated in any manner. Examples of verification or authentification include:

(1) a signed declaration by an officer or employee of a *body corporate*;

(2) a declaration by a commissioner for oaths that a copy of a document is a true copy of the original; and

(3) a declaration by the *person's* accountant or auditor that the information provided appears to be accurate.

2 Short selling

2.1 Application and purpose

Application

2.1.1 R This chapter applies to all *persons* who:

(1) engage, or are intending to engage, in short selling in relation to *relevant financial instruments*; or

(2) have engaged in short selling in relation to *relevant financial instruments* where the resulting short position is still open.

Purpose

2.1.2 G The purpose of this chapter is to set out *rules* and provide *guidance* in relation to short selling in order to promote the *FSA's* statutory objectives of:

(1) maintaining confidence in the *UK financial system*; and

(2) contributing to the protection and enhancement of the stability of the *UK financial system*.

2.2 Disclosure of disclosable short positions

Disclosure during a rights issue period

2.2.1 R A *person* who has a *disclosable short position* must provide *disclosure* of his position where:

(1) the position relates, directly or indirectly, to *securities* which are:

(a) the subject of a *rights issue*;

(b) admitted to trading on a *prescribed market* in the *United Kingdom*; and

(c) issued by:

(i) a *UK company*; or

(ii) a non-*UK company* for whom the *UK prescribed market* is the sole or main venue for trading the *securities*; and

(2) the *disclosable short position*:

(a) is reached or exceeded, or the position falls below a *disclosable short position*, during a *rights issue period*; or

(b) has been reached or exceeded immediately before the beginning of the *rights issue period* and has not fallen below a *disclosable short position* at the time the *rights issue period* commences.

2.2.2 G For the purposes of *FINMAR* 2.2.1R(1)(c)(ii), a *UK prescribed market* is the main venue for trading *securities* of a *company* where the volume of the *securities* traded on that market in the 12 month period immediately preceding the beginning of the *company's rights issue period* is greater than the volume of the *securities* traded on any other market, whether in the *United Kingdom* or elsewhere.

Disclosure of a short position in a UK financial sector company

2.2.3 R A *person* who has a *disclosable short position* in a *UK financial sector company* must provide *ongoing disclosure* of his position.

2.2.4 G Where a *UK financial sector company* is in a *rights issue period*, a disclosure under *FINMAR* 2.2.3R is sufficient to satisfy the disclosure requirement in *FINMAR* 2.1.1R.

2.3 Calculation of net short position

Preliminary

2.3.1 G This section contains provisions relating to the calculation of a *net short position* for the purposes of determining whether a *person* has a *disclosable short position*.

2.3.2 R A *net short position* is the position remaining after deducting a long position (if any) that a *person* holds in relation to the issued capital of a *company* from a short position in relation to the issued capital of that *company*, where the value of the long and short positions is calculated in accordance with the provisions below.

2.3.3 R The calculation of a *net short position* must take account of any form of economic interest, whether by virtue of a long or short position, in the issued capital of the *company*.

2.3.4 R A *net short position* must be calculated on the basis of the position held at midnight at the end of each day that a person has the *net short position*.

Long and short positions

2.3.5 R A 'long position' is the total of:

(1) the number of *shares* a *person* holds in a *company*; and

(2) any exposure, calculated on a delta-adjusted basis, to the issued capital of the *company* the *person* has through his holding of *financial instruments* which will result in the *person* making a profit, whether directly or indirectly, if there is an increase in the price or value of the *shares* of the *company*.

2.3.6 R A 'short position' is the total of:

(1) the number of *shares* in a *company* that a *person* has sold where the *person* has borrowed or needs to borrow or purchase *shares* to settle the transaction and the *shares* have not yet been returned to the lender, or borrowed and returned to the lender, or purchased, as the case may be; and

(2) any exposure, calculated on a delta-adjusted basis, to the issued capital of the *company* the *person* has through his holding of *financial instruments* which will result in the *person* making a profit, whether directly or indirectly, if there is a decrease in the price or value of the *shares*.

Calculating short positions: particular cases

2.3.7 R For the purposes of calculating a *net short position* when a *company* is in a *rights issue period*:

(1) a long position in the nil paid rights cannot be deducted from a short position in relation to the *company*; and

(2) any short position in the nil paid rights must be taken into account.

2.3.8 R Where a *person* has an economic exposure to the issued capital of a *company* by virtue of his interest in a basket, index or exchange traded fund, the value of the exposure to the *company* must be included in the calculation of his *net short position*.

2.4 Responsibility for disclosure

Discretionary and non-discretionary managers

2.4.1 R Where a *person* has appointed one or more *discretionary investment managers* to manage some or all of his investments, the *person* must make any disclosures required under *FINMAR* 2.2.1R or *FINMAR* 2.2.3R in respect of any *disclosable short position*, unless *FINMAR* 2.4.2G applies.

2.4.2 G Where a *person* ("P") has appointed:

(1) a *discretionary investment manager* to manage some or all of his investments, P may authorise that *discretionary investment manager* to make any disclosures required by *FINMAR* 2.2.1R or *FINMAR* 2.2.3R on P's behalf in relation to the investments managed by that *discretionary investment manager*;

(2) more than one *discretionary investment manager* to manage some or all of his investments, P may authorise another *person* (such as the *operator* of an *AUT*, *ICVC* or any other fund) to make any disclosures required by *FINMAR* 2.2.1R or *FINMAR* 2.2.3R on P's behalf.

2.4.3 R Where a *discretionary investment manager* or another *person* has been authorised by a *person* ("P") to make any disclosures required by *FINMAR* 2.2.1R or *FINMAR* 2.2.3R on P's behalf, he must:

(1) provide *disclosure* or *ongoing disclosure* as required under *FINMAR* 2.3.1R or *FINMAR* 2.2.3R of P's position; and

(2) clearly identify the *person* on whose behalf he is making the disclosure.

2.4.4 R Where a *discretionary investment manager* manages investments for more than one *person*, he must provide *disclosure* or *ongoing disclosure* under *FINMAR* 2.2.1R or *FINMAR* 2.2.3R in respect of the aggregate *net short position* of all the portfolios managed by him.

2.4.5 R Where a *person* whose investments are managed by a *non-discretionary investment manager* has a *disclosable short position*, the *person* must make any disclosures required under *FINMAR* 2.2.1R or *FINMAR* 2.2.3R in respect of his position.

2.4.6 G A *person* whose investments are managed by a *non-discretionary investment manager* and who has a *disclosable short position* may authorise his *non-discretionary investment manager* to make any disclosures required by *FINMAR* 2.2.1R or *FINMAR* 2.2.3R on his behalf in respect of his position.

2.4.7 R Where a *non-discretionary investment manager* has been authorised by a *person* to make any disclosures required by *FINMAR* 2.2.1R or *FINMAR* 2.2.3R on that *person's* behalf, he must:

(1) provide *disclosure* or *ongoing disclosure* as required under *FINMAR* 2.2.1R or *FINMAR* 2.2.3R of the *person's* position; and

(2) clearly identify the *person* on whose behalf he is making the disclosure.

Groups

2.4.8 R Where one or more *companies* in a group is required to disclose a *disclosable short position*, each *company* must make a separate disclosure of its own position unless *FINMAR* 2.4.9G applies.

2.4.9 G One *company* in a group may make a disclosure of a *disclosable short position* held by one or more *companies* in the group, provided that the disclosure clearly states the name of the *company* or of each of the *companies*, as the case may be, which holds a *disclosable short position*.

Editor's Note: The following chapter (FINMAR 3) replaces COND 3, which is deleted. Changes from the text of COND 3 are indicated by underlining (new text) and striking through (deleted text).

3 Banking Act 2009

3.1 Application and purpose

Application

3.1.1 G *FINMAR* 3 is relevant to *firms* subject to the powers in Parts 1 to 3 of the Banking Act 2009 (the Banking Act), that is, *UK* incorporated *firms* with a *Part IV permission* to carry on the *regulated activity* of *accepting deposits*, other than *credit unions*, *firms* with a *Part IV permission* to *effect* or *carry out contracts of insurance* and any other class of institution specified in secondary legislation.

Purpose

3.1.2 G The purpose of *FINMAR* 3 is to provide *guidance* on assessing Condition 2 under section 7(3) of the Banking Act.

~~3.1~~ 3.2 Assessing Condition 2 under section 7(3) of the Banking Act 2009

Introduction

~~3.1.1~~ 3.2.1 G The Banking Act ~~2009 (the Banking Act)~~ introduces new powers for HM Treasury, the Bank of England and the *FSA* to deal with failing banks. The powers, which are set out in Parts 1 to 3 of that Act, can be used to deal with *UK* incorporated *firms* with a *Part IV permission* to carry on the *regulated activity* of *accepting deposits*, other than *credit unions*, *firms* with a *Part IV permission* to *effect* or *carry out contracts of insurance* and any other class of institution specified in secondary legislation. In relation to *building societies*, the main tools in the Act are applied with modifications. In this section the term "bank" is used to refer to those *firms* that are potentially subject to the powers in Parts 1 to 3 of the Banking Act. The powers are defined in the Banking Act, and referred to in this section as the "stabilisation powers". The Banking Act contains powers to enable HM Treasury to extend the application of the stabilisation powers to *credit unions* by secondary legislation.

~~3.1.2~~ 3.2.2 G Section 7 of the Banking Act sets out the two conditions that must be met before a stabilisation power can be exercised in respect of a bank:

(1) Condition 1 is that the bank is failing, or is likely to fail, to satisfy the *threshold conditions*.

(2) Condition 2 is that, having regard to timing and other relevant circumstances, it is not reasonably likely that (ignoring the stabilisation powers) action will be taken by or in respect of the bank that will enable it to satisfy the *threshold conditions*.

~~3.1.3~~ 3.2.3 G The Banking Act provides that the *FSA* is to treat Conditions 1 and 2 as met if satisfied that they would be met but for financial assistance provided by either HM Treasury or the Bank of England (disregarding ordinary market assistance offered by the Bank on its usual terms).

Assessing Condition 1

~~3.1.4~~ 3.2.4 G The matters the *FSA* will take into account in assessing whether a bank is failing or is likely to fail to satisfy the *threshold conditions* are described in *COND* 2.1 to *COND* 2.5. The options available to the *FSA* in the case of a breach of the *threshold conditions* are outlined in Chapter 8 of the *Enforcement Guide* and *SUP* 7.2. These tools are available to the *FSA* at any time, and so may be used before or in conjunction with the stabilisation tools provided by the Banking Act.

Assessing Condition 2

~~3.1.5~~ 3.2.5 G The Banking Act provides that in considering the test in Condition 2, the *FSA* should ignore the stabilisation powers. The purpose of this limitation is to make clear that in making its assessment, the *FSA* is not considering whether the stabilisation powers could successfully resolve the situation, but is considering whether alternative measures might provide for this instead.

Timing

~~3.1.6~~ 3.2.6 G In assessing Condition 2, the *FSA* will consider the timeframe during which any actions taken by or in relation to the bank are likely to be available and to have effect. In the view of the *FSA*, the purpose of the reference to timing in Condition 2 is to require the *FSA* to consider whether a return to full compliance is likely to occur within a reasonable period of time. The following is a non-exhaustive list of factors the *FSA* may consider:

(1) the extent of any loss, or risk of loss, or other adverse effect on *consumers*. The more serious the loss or potential loss or other adverse effect, the more likely it is that the *FSA* will consider that remedial action will be needed urgently;

(2) the seriousness of any suspected breach of the requirements of the *Act* or the *rules* and the steps that need to be taken to correct that breach;

(3) the risk that the bank's conduct or business presents to the stability of the *UK financial system* and to confidence in that system;

(4) the likelihood that remedial action that could be taken by or in relation to the bank will take effect before *consumers*, ~~or~~ market confidence or financial stability suffers significant detriment.

~~3.1.7~~ 3.2.7 G If the *FSA* is satisfied that the breach of *threshold conditions* is likely to be temporary and to be rectified within a reasonable time, the *FSA* is unlikely to conclude that Condition 2 has been met.

Other relevant circumstances

~~3.1.8~~ 3.2.8 G In general the *FSA* will be concerned to determine whether any remedial action that could be taken by or in relation to the bank will be effective. This will include an assessment of both how likely it is that the action will be taken, and if it is, the impact it will have on the bank's compliance with the *threshold conditions*. Circumstances that the *FSA* may take into account include but are not limited to:

(1) where the *FSA's* concerns relate to adequacy of liquidity:

(a) the availability of market funding to banks generally and any specific circumstances of the bank that may impact on its ability to access the market on terms which are generally available;

(b) whether the bank's current funding structure is adequate and viable; whether the primary sources of funding continue to be available, given current market sentiment, and whether they would still be viable if market sentiment was to change;

(c) the maturity profile of the bank's existing funding and the availability of funding from the market to replace maturing funding as the need arises;

(d) whether liquidity problems call into question adequacy of capital;

(e) the bank's credit rating and the likelihood and impact of any potential downgrade;

(f) the availability and terms of liquidity support from group *companies*, existing funders and central banks;

(2) where the *FSA's* concerns relate to capital:

(a) the availability of capital from the market for banks in general and any specific circumstances of the bank that may impact on its ability to access the market on terms which are generally available;

(b) potential sources of capital and the nature of and terms on which capital may be obtained;

(c) the success of any recent attempts by the bank to raise capital on the open market;

(d) the willingness of existing significant institutional investors to provide or assist in a strategic solution to the bank;

(3) where the *FSA's* concerns relate to the adequacy of non-financial resources or suitability, the *FSA* will take into account the factors identified in *COND* 2.4 and 2.5, and other *Handbook* provisions referred to in those chapters. In assessing Condition 2, the circumstances of each case are likely to be different, but the *FSA* will be concerned to establish the likelihood of achieving a return to full compliance with the *threshold conditions*, and the timescale in which a return to compliance will be effected;

(4) the prospects of the bank securing a material and relevant transaction with a third party, for example a sale of the bank itself or of all or part of its business. In relation to any transaction, the *FSA* will have regard to factors including but not limited to:

(a) the status of any ongoing negotiations;

(b) the level of interest expressed and the credibility of potential counterparties;

(c) practical constraints related to the bank itself, for example, management engagement, availability of relevant information and severability of infrastructure;

(d) the sources, availability and firmness of financing for any transaction;

(e) the need for shareholder approval, merger clearances or other consents;

(f) the suitability of the counterparty and the stability of the relevant parties following completion of any transaction.

~~3.1.9~~ 3.2.9 G When assessing whether the bank will return to compliance with *threshold condition* 4 (adequate resources) the *FSA* will also assess the reasons behind the likely or actual failure of compliance. Serious failures of management, systems or internal controls may in themselves call into question the adequacy of the bank's non-financial resources (*threshold condition* 4) or suitability (*threshold condition* 5). Therefore, in assessing whether a bank is reasonably likely to satisfy the *threshold conditions* in the future, the *FSA* will be concerned to ensure that any such failures have been adequately addressed.

Schedule 1 Record keeping requirements

Sch 1.1 G There are no record-keeping requirements in *FINMAR*.

Schedule 2 Notification requirements

Sch 2.1 G There are no notification requirements in *FINMAR*.

Schedule 3 Fees and other required payments

Sch 3.1 G There are no requirements for fees in *FINMAR*.

Schedule 4 Powers Exercised

Sch 4.1 G

The following powers and related provisions in or under the *Act* have been exercised by the *FSA* to make the *rules*, statements of policy and guidance in *FINMAR*:	
	Section 131B (Short selling rules)

	Section 157(1) (Guidance)
	Section 165B(6) ([Statement of policy])

Schedule 5 Rights of action for damages

Sch 5.1 G There are no rules in *FINMAR*.

Schedule 6 Rules that can be waived

Sch 6.1 G There are no rules in *FINMAR*.

Annex B

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

disclosure	disclosure of a *disclosable short position* which: (a) is made on a *RIS* by no later than 3.30pm on the *business day* following the day on which the position reaches, exceeds or falls below a *disclosable short position* of 0.25% of the issued capital of a *company*; and (b) includes the name of the *person* who has the *disclosable short position*, the amount of the *disclosable short position* and the name of the *company* in relation to which the *person* has that position.
FINMAR	the Financial Stability and Market Confidence sourcebook.
financial stability information power	the *FSA's* power under section 165A of the *Act* (Authority's power to require information: financial stability) which, in summary, is a power to require a *person* to provide information or documents relevant to the stability of one or more aspects of the *UK financial system*.
financial stability information requirement	a requirement imposed on a *person* by the *FSA* using the *financial stability information power* or the *overseas financial stability information power*.
net short position	a position which gives rise to an economic exposure to the issued capital of a *company*, calculated in accordance with *FINMAR* 2.
ongoing disclosure	disclosure of a *disclosable short position* which: (a) is made on a *RIS* by no later than 3.30pm on the *business day* following the day on which the position reaches, exceeds or falls below a *net short position* of 0.25%, 0.35%, 0.45% and 0.55% of the issued capital of a *company* and each 0.1% threshold thereafter; and (b) includes the name of the *person* who has the *disclosable short position*, the amount of the *disclosable short position* and the name of the *company* in relation to which the *person* has that position.

overseas financial stability information power	the *FSA's* power under section 169A of the *Act* (Support of overseas regulator with respect to financial stability) which, in summary, is a power exercisable at the request of an *overseas regulator* to require a *person* to provide information or documents relevant to the stability of one or more aspects of the *relevant financial system* operating in the country or territory of that regulator.
relevant financial instrument	(in accordance with sections 131C(4) and 131C(5) of the *Act*) a *financial instrument* that: (a) is admitted to trading on a *regulated market* or any other *prescribed market* in an *EEA State*; or (b) has such other connection with a market in an *EEA State* as may be specified by the *short selling rules*.
relevant financial system	(in accordance with section 169A(5) of the *Act* (Support of overseas regulator with respect to financial stability)) a financial system including: (a) financial markets and exchanges; (b) activities that would be *regulated activities* if carried on in the *United Kingdom*; and (c) other activities connected with financial markets and exchanges.
short selling rules	(in accordance with section 131B(8) of the *Act*) rules concerning the prohibition or disclosure of short selling in relation to *relevant financial instruments*.
UK financial system	(as defined in section 3 of the *Act* (Market confidence)) the financial system operating in the *United Kingdom* including: (a) financial markets and exchanges; (b) *regulated activities*; and (c) other activities connected with financial markets and exchanges.

Amend the following definitions as shown.

competent authority	(1) …

(2) (in relation to the exercise of an *EEA right* and the exercise of the *overseas financial stability information power*) a competent authority for the purposes of the relevant *Single Market Directive*.

…

disclosable short position

a ~~net short position~~ *net short position* which represents an economic interest of one quarter of ~~one per cent~~ 1% or more of the issued capital of a ~~company~~ *company*, excluding any interest held in the capacity of a *market maker*.

~~In calculating whether a holder has a *disclosable short position*, the holder should take into account any form of economic interest it has in the shares of the *issuer*, excluding any interest which he holds as a market maker in that capacity~~.

discretionary investment manager

(in *COBS*, *FINMAR* and (in relation to *firm type*) in *SUP* 16.10 (Confirmation of ~~*standing data*~~ standing data)) a *person* who, acting only on behalf of a *client*, manages *designated investments* in an account or portfolio on a discretionary basis under the terms of a discretionary management agreement.

~~*financial system*~~

~~(as defined in section 3 of the *Act* (Market confidence)) the financial system operating in the *United Kingdom* including:~~

~~(a) financial markets and exchanges;~~

~~(b) *regulated activities*; and~~

~~(c) other activities connected with financial markets and exchanges.~~

market maker

(1) (except in *COBS* and *FINMAR*) (in relation to an *investment*) a *person* who (otherwise than in his capacity as the *operator* of a *regulated collective investment scheme*) holds himself out as able and willing to enter into transactions of sale and purchase in *investments* of that description at prices determined by him generally and continuously rather than in respect of each particular transaction.

(2) (in *COBS*) a *person* who holds himself out on the financial markets on a continuous basis as being willing to deal on own account by buying and selling *financial instruments* against his proprietary capital at prices defined by him.

[**Note:** article 4(1)(8) of *MiFID*]

(3) (in *FINMAR*) a *person* who, ordinarily as part of his business, deals as principal in *financial instruments* (whether *OTC* or exchange traded):

(a) to fulfil orders received from another *person* in response to that *person's* request to trade or to hedge positions arising out of those dealings; or

(b) in a way that ordinarily has the effect of providing liquidity on a regular basis to the financial markets on both bid and offer sides of the market in comparable size.

non-discretionary investment manager (in *FINMAR* and in relation to *firm type* in *SUP* 16.10 (Confirmation of ~~*standing data*~~ standing data)) a *person* who, acting only on behalf of a *client*, manages *designated investments* in an account or portfolio on a non-discretionary basis under the terms of a non-discretionary management agreement.

overseas regulator

(1) (except in relation to the *overseas financial stability information power*) (as defined in section 195(3) of the *Act* (Exercise of power in support of overseas regulator)) an authority in a country or territory outside the *United Kingdom*:

(a) …

…

(2) (in relation to the *overseas financial stability information power*) (as defined in section 169A(2) of the *Act* (Support of overseas regulator with respect to financial stability)) an authority in a country or territory outside the *United Kingdom* which exercises functions with respect to the stability of the *relevant financial system* operating in that country or territory.

rights issue (in *LR* and *FINMAR*) an offer to existing *security* holders to subscribe or purchase further *securities* in proportion to their holdings made by means of the issue of a renounceable letter (or other negotiable document) which may be traded (as "nil paid" rights) for a period before payment for the *securities* is due.

rights issue period the period that commences on the date a *company* announces a ~~rights issue~~ *rights issue* and which ends on the date that the ~~*shares*~~ *securities* issued under the ~~rights issue~~ *rights issue* are admitted to trading on a *prescribed market*.

Annex C

Amendments to the Threshold Conditions (COND)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

1.1.1 G *COND* applies to every *firm*, except that:

…

(3) *threshold conditions* 3, 4 and 5 do not apply to a *Swiss General Insurance Company*; and

(4) *COND* 2.6 (Additional conditions) is only relevant to *non-EEA insurers*~~; and~~.

(5) ~~*COND* 3.1 is only relevant to *firms* falling within the scope of the Banking Act 2009 (see *COND* 3.1.1G).~~ [deleted]

…

COND 3 is deleted in its entirety. The deleted text is not shown struck through.

3 Banking Act 2009 [deleted] This chapter has been moved to FINMAR 3

Annex D

Amendments to the Market Conduct sourcebook (MAR)

In this Annex, underlining indicates new text and striking through indicates deleted text.

1.9 Market abuse (misleading behaviour) and market abuse (distortion)

…

1.9.2A E ~~Failure by a person to give adequate disclosure that he has reached or exceeded a *disclosable short position* where:~~

~~(1) that position relates, directly or indirectly, to *securities* which are the subject of a rights issue; and~~

~~(2) the *disclosable short position* is reached or exceeded during a *rights issue period*;~~

~~is *behaviour* which, in the opinion of the *FSA*, is *market abuse (misleading behaviour).*~~ [deleted]

1.9.2B R ~~For the purposes of *MAR* 1.9.2AE, "adequate disclosure" means disclosure made on a *RIS* by no later than 3.30pm on the *business day* following the date on which the *disclosable short position* is reached or exceeded. The disclosure must include the name of the person who has the *disclosable short position*, the *disclosable short position* and the name of the *issuer* of the *qualifying instruments*.~~ [deleted]

Short selling in relation to financial sector companies

1.9.2C E …

1.9.2D E (1) ~~Failure by a person who has a *disclosable short position* in a *UK financial sector company* to provide adequate ongoing disclosure of their position is *behaviour* which, in the opinion of the *FSA*, is *market abuse (misleading behaviour).*~~ [deleted]

(2) ~~In (1), "adequate ongoing disclosure" means disclosure made on a *RIS* by no later than 3.30pm on the *business day* following the day on which the position reaches, exceeds or falls below a *disclosable short position* of 0.25%, 0.35%, 0.45% and 0.55% of the issued share capital of the company and each 0.1% threshold thereafter.~~ [deleted]

(a) [deleted]

(b) [deleted]

(2A) ~~The disclosure referred to in (1) must include the name of the person who has the position, the amount of the *disclosable short position*~~

~~and the name of the company in relation to which it has that position.~~ [deleted]

(3) ~~For the avoidance of doubt, changes in a *disclosable short position* between the thresholds referred to in (2) do not need to be disclosed under this section. For example, an increase from 0.25% to 0.31% of the issued share capital of the company does not need to be disclosed.~~ [deleted]

(4) ~~For the avoidance of doubt, (1) applies during a *rights issue period*.~~ [deleted]

(5) [deleted]

Financial Services Compensation Scheme (Financial Services Act 2010)

Instrument 2010

FINANCIAL SERVICES COMPENSATION SCHEME (FINANCIAL SERVICES ACT 2010) INSTRUMENT 2010

Powers exercised

A. The Financial Services Authority makes this instrument in the exercise of:

(1) the powers and related provisions in the following sections of the Financial Services and Markets Act 2000 ("the Act"):

(a) section 138 (General rule-making power);
(b) section 156 (General supplementary powers);
(c) section 157(1) (Guidance);
(d) section 213 (The compensation scheme);
(e) section 214 (General); and
(f) section 224F (Rules about relevant schemes); and

(2) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.

B. The rule-making powers referred to above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force as follows:

(1) Part 1 of Annex A and Part 1 of Annex B come into force on 1 August 2010; and
(2) the remainder of this instrument comes into force on [*date*].

Amendments to the Handbook

D. The Glossary of definitions is amended in accordance with Annex A to this instrument.

E. The Fees manual (FEES) is amended in accordance with Annex B to this instrument.

Citation

F. This instrument may be cited as the Financial Services Compensation Scheme (Financial Services Act 2010) Instrument 2010.

By order of the Board
[22 July 2010]

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Part 1 Comes into force on 1 August 2010

compensation costs the costs incurred:

(a) in paying compensation; or

(b) as a result of making the arrangements contemplated in *COMP* 3.3.1R or taking the measures contemplated in *COMP* 3.3.3R; or

(c) in making payments or giving indemnities under *COMP* 11.2.3R; or

(d) under section 214B or section 214D of the *Act*; or

(e) by virtue of section 61 (Sources of compensation) of the Banking Act 2009.

Part 2 Comes into force on [*date*]

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

MERS levy a levy (management expenses in respect of relevant schemes levy) imposed by the *FSCS* on *participant firms* to meet the management expenses incurred by the *FSCS* in connection with acting on behalf of the *manager of the relevant scheme* in accordance with Part 15A of the *Act.*

manager of the relevant scheme the *person* (including a *person* outside the *United Kingdom*) who administers the *relevant scheme* or (if there is no such *person*) the *person* responsible for making payments under it.

Amend the following as shown.

management expenses	(1)	(except in *INSPRU*) (in accordance with section 223 of the *Act* (Management expenses)) expenses incurred or expected to be incurred by the *FSCS* in connection with its function under ~~*COMP*~~ the *Act*, other than *compensation costs* and costs incurred under Part 15A of the *Act*; for the purposes of ~~*COMP*~~ *FEES* 6 these are subdivided into *base costs*, *specific costs* and *establishment costs*.
	(2)	…
relevant scheme	(1)	(except in *FEES* 6) a *collective investment scheme* managed by an *EEA UCITS management company*.
	(2)	(in *FEES* 6) a scheme or arrangement (other than the *compensation scheme*) for the payment of compensation (in certain cases) to customers (including customers outside the *United Kingdom*) of *persons* (including *persons* outside the *United Kingdom*) who provide financial services (including financial services provided outside the *United Kingdom*) or carry on a business connected with the provision of such services.

Annex B

Amendments to the Fees manual (FEES)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Part 1: Comes into force on 1 August 2010

6.1.9 G Section 223 of the *Act* (Management expenses) prevents the *FSCS* from recovering, through a levy, any *management expenses* attributable to a particular period in excess of the limit set in *COMP* as applicable to that period. 'Management expenses' are defined in section 223(3) to mean expenses incurred or expected to be incurred by the *FSCS* in connection with its functions under the *Act*, except:

(1) expenses incurred in paying compensation; ~~and~~

(2) expenses incurred as a result of the *FSCS* making the arrangements to secure continuity of insurance set out in *COMP* 3.3.1R and *COMP* 3.3.2R or taking the measures set out in *COMP* 3.3.3R and *COMP* 3.3.4R when a *relevant person* is an *insurer* in financial difficulties; and

(3) expenses incurred under section 214B or section 214D of the *Act* as a result of the *FSCS* being required by HM Treasury to make payments in connection with the exercise of the stabilisation power under Part 1 of the Banking Act 2009.

…

6.1.15 G *Compensation costs* are principally the costs incurred in paying compensation. Costs incurred in securing continuity of long-term insurance in safeguarding *eligible claimants* when insurers are in financial difficulties, ~~and~~ in making payments or giving indemnities under *COMP* 11.2.3R and as a result of the *FSCS* being required by HM Treasury to make payments in connection with the exercise of the stabilisation power under Part 1 of the Banking Act 2009 are also treated as *compensation costs*. For funding purposes, these costs are allocated by the *FSCS*, and met by *participant firms*, in the same way as *specific costs* up to relevant *levy limits* and then in accordance with the allocation provisions in *FEES* 6.5.2R.

Part 2: Comes into force on [*date*]

6.1.4A G Section 224F of the *Act* enables the *FSA* to make *rules* to enable the *FSCS* to impose levies on *authorised persons* (or any class of *authorised persons*) in order to meet its management expenses incurred if, under Part 15A of the *Act*, it is required by HM Treasury to act in relation to *relevant schemes*. But those *rules* must provide that the *FSCS* can impose a levy only if the

FSCS has tried its best to obtain reimbursement of those expenses from the *manager of the relevant scheme*.

6.1.5 G The *FSCS* may impose ~~two~~ three types of levy: a *management expenses levy*, ~~and~~ a *compensation costs levy* and a *MERS levy*. The *FSCS* has discretion as to the timing of the levies imposed.

…

6.1.9 G Section 223 of the *Act* (Management expenses) prevents the *FSCS* from recovering, through a levy, any *management expenses* attributable to a particular period in excess of the limit set in *COMP* as applicable to that period. 'Management expenses' are defined in section 223(3) to mean expenses incurred or expected to be incurred by the *FSCS* in connection with its functions under the *Act*, except:

(1) …

(2) expenses incurred as a result of the *FSCS* making the arrangements to secure continuity of insurance set out in *COMP* 3.3.1R and *COMP* 3.3.2R or taking the measures set out in *COMP* 3.3.3R and *COMP* 3.3.4R when a *relevant person* is an *insurer* in financial difficulties; ~~and~~

(3) expenses incurred under section 214B or section 214D of the *Act* as a result of the *FSCS* being required by HM Treasury to make payments in connection with the exercise of the stabilisation power under Part 1 of the Banking Act 2009; and

(4) expenses incurred under Part XVA of the *Act* as a result of the *FSCS* being required by HM Treasury to act in relation to a *relevant scheme*.

…

6.3.1 R The *FSCS* may at any time impose a *management expenses levy*, ~~or~~ a *compensation costs levy* or a *MERS levy*, provided the *FSCS* has reasonable grounds for believing that the funds available to it to meet relevant expenses are, or will be, insufficient, taking into account:

…

…

6.3.3 G The *FSCS* may impose one or more levies in a financial year to meet ~~either~~ its *management expenses*, ~~or~~ its *compensation costs* or its management expenses in respect of *relevant schemes*. ...

…

After FEES 6.4 insert the following new section. The text is not underlined.

6.4A Management expenses in respect of relevant schemes

Obligation on participant firm to pay

6.4A.1 R A *participant firm* must pay to the *FSCS* a share of each *MERS levy*.

Restriction on management expenses in respect of relevant schemes

6.4A.2 R The *FSCS* can impose a *MERS levy* only if the *FSCS* has tried its best and has failed to obtain reimbursement of those expenses from the manager of the relevant compensation scheme.

Management expenses in respect of relevant schemes levy

6.4A.3 R The *FSCS* must calculate a *participant firm's* share of a *MERS levy* on a reasonable basis.

Amend the following as shown.

Sch 4 Powers exercised

G	The following powers and related provisions in or under the *Act* have been exercised by the *FSA* to make the *rules* in *FEES*:	
		…
		Section 223C (Payments in error)
		Section 224F (Rules about relevant schemes)
		…

Consequential amendments (Financial Services Act 2010)

Instrument 2010

CONSEQUENTIAL AMENDMENTS (FINANCIAL SERVICES ACT 2010) INSTRUMENT 2010

Powers exercised

A. The Financial Services Authority makes this instrument in the exercise of:

(1) the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(a) section 138 (General rule-making power);
(b) section 156 (General supplementary powers);
(c) section 157(1) (Guidance); and

(2) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.

B. The rule-making powers referred to above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on 6 August 2010.

Amendments to the Handbook

D. The modules of the FSA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Principles for Businesses (PRIN)	Annex B
Senior Management Arrangements, Systems and Controls sourcebook (SYSC)	Annex C
Threshold Conditions (COND)	Annex D
Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)	Annex E
Prudential sourcebook for Insurers (INSPRU)	Annex F
Prudential sourcebook for UCITS Firms (UPRU)	Annex G
Supervision manual	Annex H
Compensation sourcebook (COMP)	Annex I
Credit Unions sourcebook (CRED)	Annex J
Electronic Money sourcebook (ELM)	Annex K
Professional Firms sourcebook (PROF)	Annex L
Recognised Investment Exchanges and Recognised Clearing Houses sourcebook (REC)	Annex M

Citation

E. This instrument may be cited as the Consequential amendments (Financial Services Act 2010) Instrument 2010.

By order of the Board
[date]

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text.

consumer	(1)	…
	(2)	(in relation to the *FSA's* power to make general *rules* (section 138 of the *Act* (General rule-making power)), the approval requirements for *controllers* (section 186 of the *Act* (Objection to acquisition of control)), the publication of notices (section 391 of the *Act* (Publication)) and the exercise of *Treaty rights* (Schedule 4 to the *Act* (Treaty rights))) ~~(as defined in section 138(7) of the *Act* (General rule-making power))~~ a *person*:
		…
prudential context	in relation to activities carried on by a *firm*, the context in which the activities have, or might reasonably be regarded as likely to have, a negative effect on:	
	(a)	confidence in the <u>*UK* *financial system*</u>; or
	…	
regulatory objectives	(as described in sections 2(2) and 3 to 6 of the *Act*)	
	(a)	market confidence;
	(b)	public awareness;
	(c)	the protection of *consumers*; ~~and~~
	(d)	the reduction of *financial crime*<u>; and</u>
	<u>(e)</u>	<u>financial stability</u>.

Annex B

Amendments to the Principles for Businesses (PRIN)

In this Annex, underlining indicates new text and striking through indicates deleted text.

1.1.6 G As set out in *PRIN* 3.3 (Where?), *Principles* 1 (Integrity), 2 (Skill, care and diligence) and 3 (Management and control) apply to world-wide activities in a *prudential context*. *Principle* 5 (Market conduct) applies to world-wide activities which might have a negative effect on confidence in the *UK financial system* ~~operating in the *United Kingdom*~~. In considering whether to take regulatory action under these *Principles* in relation to activities carried on outside the *United Kingdom*, the *FSA* will take into account the standards expected in the market in which the *firm* is operating. *Principle* 11 (Relations with regulators) applies to world-wide activities; in considering whether to take regulatory action under *Principle* 11 in relation to cooperation with an overseas regulator, the *FSA* will have regard to the extent of, and limits to, the duties owed by the *firm* to that regulator. (*Principle* 4 (Financial prudence) also applies to world-wide activities.)

…

3.3.1 R Territorial application of the Principles

Principle	Territorial application
…	
Principle 5	if the activities have, or might reasonably be regarded as likely to have, a negative effect on confidence in the *UK financial system* ~~operating in the *United Kingdom*~~, applies with respect to activities wherever they are carried on; otherwise, applies with respect to activities carried on from an establishment maintained by the *firm* (or its *appointed representative*) in the *United Kingdom*.
…	

Annex C

Amendments to the Senior Management Arrangements, Systems and Controls sourcebook (SYSC)

In this Annex, underlining indicates new text and striking through indicates deleted text.

3.2.11 G (1) …

(2) Risks of regulatory concern are those risks which relate to the fair treatment of the *firm's customers*, to the protection of *consumers*, to confidence in the *UK financial system*, ~~and~~ to the use of that system in connection with *financial crime*, and to financial stability.

…

14.1.4 G The purpose of this section is to serve the *FSA's regulatory objectives* of consumer protection, ~~and~~ market confidence and financial stability. In particular, this section aims to reduce the risk that a *firm* may pose a threat to these *regulatory objectives*, either because it is not prudently managed, or because it has inadequate systems to permit appropriate senior management oversight and control of its business.

…

14.1.51 G *SYSC* 3.2.20R requires a *firm* to take reasonable care to make and retain adequate records. The following policy on record keeping supplements *SYSC* 3.2.20R by providing some additional *rules* and *guidance* on record keeping in a *prudential context*. The purpose of this policy is to:

(1) …

(2) help the *FSA* to satisfy itself that a *firm* is operating in a prudent manner and is not prejudicing the interests of its *customers*, ~~or~~ market confidence or financial stability.

…

15.1.5 G Credit risk concerns the *FSA* in a *prudential context* because inadequate systems and controls for credit risk management can create a threat to the *regulatory objectives* of market confidence, ~~and~~ consumer protection and financial stability by:

…

…

17.1.4 G Insurance risk concerns the *FSA* in a *prudential context* because inadequate systems and controls for its management can create a threat to the *regulatory objectives* of market confidence, ~~and~~ consumer protection and financial stability. Inadequately managed insurance risk may result in:

…

Annex D

Amendments to the Threshold Conditions (COND)

In this Annex, underlining indicates new text and striking through indicates deleted text.

2.5.7 G In determining whether a *firm* will satisfy and continue to satisfy *threshold condition* 5 in respect of having competent and prudent management and exercising due skill, care and diligence, relevant matters, as referred to in *COND* 2.5.4G(2), may include, but are not limited to whether:

…

(2) if appropriate, the *governing body* of the *firm* includes non-executive representation, at a level which is appropriate for the control of the *regulated activities* proposed, for example, as members of an audit committee ~~(see *COND* 3.2.15G (Audit Committee))~~;

…

(9) the *firm* has conducted enquiries (for example, through market research or the previous activities of the *firm*) that are sufficient to give it reasonable assurance that it will not be posing unacceptable risks to *consumers* or the *UK financial system*;

…

Annex E

Amendments to the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)

In this Annex, underlining indicates new text and striking through indicates deleted text.

12.3.9 G As part of the *SLRP*, the *FSA* will assess the appropriateness of the *liquidity risk* tolerance adopted by an *ILAS BIPRU firm* to ensure that this risk tolerance is consistent with maintenance by the *firm* of adequate liquidity resources for the purpose of the *overall liquidity adequacy rule*. The *FSA* will expect a *firm* to provide it with an adequately reasoned explanation for the level of *liquidity risk* which that *firm's governing body* has decided it should assume. In assessing the appropriateness of the *liquidity risk* tolerance adopted by a *firm*, the *FSA* will consider whether the tolerance adopted is consistent with the *firm's* satisfaction of *threshold condition* 5 (*COND* 2.5.7G(6)). Consistent with the *FSA's* statutory objectives under the *Act*, in assessing the appropriateness of a *firm's* adopted *liquidity risk* tolerance the *FSA* will also have regard to the role and importance of a *firm* in the UK *financial system*.

…

12.4.3 G Consistent with *BIPRU* 12.3.5R, the *FSA* expects that the extent and frequency of such testing, as well as the degree of regularity of *governing body* review under *BIPRU* 12.4.2R, should be proportionate to the nature scale and complexity of a *firm's* activities, as well as to the size of its liquidity risk exposures. Consistent with the *FSA's* statutory objectives under the *Act*, in assessing the adequacy of a *firm's* stress testing arrangements (including their frequency and the regularity of *governing body* review) the *FSA* will also have regard to the role and importance of that *firm* in the UK *financial system*. The *FSA* will, however, expect stress testing and *governing body* review to be carried out no less frequently than annually. The *FSA* expects that a *firm* will build into its stress testing arrangements the capability to increase the frequency of those tests in special circumstances, such as in volatile market conditions or where requested by the *FSA*.

…

12.8.5 G This section represents merely an indication of the matters to which the *FSA* will have regard in considering an application for a *whole-firm liquidity modification* or an *intra-group liquidity modification*. In considering such an application, the *FSA* will always take into account anything that it reasonably considers to be relevant for the purposes of assessing whether the statutory tests in section 148 of the *Act* are met. In doing so, it will have regard to the role and importance of a *firm* or *UK branch* in the UK *financial system*.

…

12.8.12 G In determining the appropriate duration of an *intra-group liquidity modification*, the *FSA* will have regard to the role and importance of the *firm* in question in the *UK financial system*. In some cases, the *FSA* may take the view that an *intra-group liquidity modification* covering a *firm* whose role and importance in the *UK financial system* are significant ought to be reviewed more regularly than one granted in respect of a less systemically significant *firm*. The *FSA* will consider this issue in determining the appropriate duration of such a modification.

…

12.8.30 G In determining the appropriate duration of a *whole-firm liquidity modification*, the *FSA* will have regard to the role and importance of the *UK branch* in question in the *UK financial system*. In some cases, the *FSA* may take the view that a *whole-firm liquidity modification*, covering a *UK branch* whose role and importance in the *UK financial system* are significant, ought to be reviewed more regularly than one granted in respect of a less systemically significant *branch*. …

Annex F

Amendments to the Prudential sourcebook for Insurers (INSPRU)

In this Annex, underlining indicates new text and striking through indicates deleted text.

5.1.4	G	Operational risk concerns the *FSA* in a *prudential context* because inappropriate management of operational risk can adversely affect the solvency or business continuity of a *firm*, threatening the *regulatory objectives* of market confidence, ~~and~~ consumer protection and financial stability.

Annex G

Amendments to the Prudential sourcebook for UCITS Firms (UPRU)

In this Annex, underlining indicates new text and striking through indicates deleted text.

1.2.1	G	(1)	The purpose of this sourcebook is to amplify *Principle* 4 (Financial prudence) which requires a *firm* to maintain adequate financial resources to meet its *designated investment business* commitments and to withstand the risks to which its business is subject. This assists in the achievement of the *regulatory objectives* of consumer protection, ~~and~~ market confidence and financial stability.
		…	

Annex H

Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text.

1.1.3 G The design of these arrangements is shaped by the *regulatory objectives*. These are set out in section 2 of the *Act* (The Authority's general duties) and are:

(1) maintaining confidence in the *UK financial system*;

(1A) contributing to the protection and enhancement of the stability of the *UK financial system*;

(2) promoting public understanding of the *UK financial system*;

…

…

1.3.3 G The impact of a *firm* is assessed by reference to a range of factors derived from the *regulatory objectives*, including:

(1) …

(1A) the extent to which the *firm* may pose risks to the stability of the *UK financial system*;

…

…

2.1.3 G Achieving the *regulatory objectives* involves the *FSA* informing itself of developments in *firms* and in markets. The *Act* requires the *FSA* to monitor a *firm's* compliance with requirements imposed by or under the *Act* (paragraph 6 (1) of Schedule 1). The *Act* also requires the *FSA* to take certain steps to cooperate with other relevant bodies and regulators (section 354). For these purposes, the *FSA* needs to have access to a broad range of information about a *firm's* business.

…

2.1.5 G Part XI of the *Act* (Information Gathering and Investigations) gives the *FSA* statutory powers, including:

(1) to require the provision of information (see ~~section~~ sections 165, 165A, ~~and~~ *EG* 3 and *FINMAR* 1);

…

…

2.3.12 G In complying with *Principle* 11, the *FSA* considers that a *firm* should cooperate with it in providing information for other regulators. ~~Section~~ Sections 169 ~~of the *Act*~~ (Investigations etc. in support of overseas regulator) and 169A (Support of overseas regulator with respect to financial stability) of the *Act* ~~gives~~ give the *FSA* certain statutory powers to obtain information and appoint investigators for *overseas regulators* if required (see *DEPP* 7~~, and~~ *EG* 3 and *FINMAR* 1).

…

6.3.28 G (1) The *FSA* is required by section 41(2) of the *Act* to ensure that a *firm* applying to vary its *Part IV permission* satisfies and will continue to satisfy the *threshold conditions* in relation to all the regulated activities for which the *firm* has or will have *Part IV permission* after the variation. However, the *FSA's* duty under the *Act* does not prevent it, having regard to that duty, from taking such steps as it considers necessary in relation to a particular *firm*, to ~~secure its *consumer* protection objective~~ meet any of its *regulatory objectives*. This may include granting a *firm's* application for variation of *Part IV permission* when it wishes to wind down (run off) its business activities and cease to carry on new business as a result of no longer being able to satisfy the *threshold conditions*.

(2) In addition, the *FSA* may refuse the application if it appears that ~~the interests of *consumers*, or a group of *consumers*~~, any of its *regulatory objectives* would be adversely affected if the application were to be granted and it is desirable ~~in the interests of *consumers*, or that group of *consumers*~~, in order to meet any of its *regulatory objectives* for the application to be refused.

…

6.4.2 G Under section 44(3) of the *Act*, the *FSA* may refuse an application from a *firm* to cancel its *Part IV permission* if it appears that~~:~~ it is desirable for the application to be refused in order to meet any of the *FSA's regulatory objectives*.

~~(1) the interests of *consumers*, or potential *consumers*, would be adversely affected if the application were to be granted; and~~

~~(2) it is desirable in the interests of *consumers*, or potential *consumers*, for the application to be refused.~~

…

6 Annex 4.1G Additional guidance for a firm winding down (running off) its business

…	

3.	If appropriate, in the interests of ~~*consumer* protection~~ its *regulatory objectives*, the *FSA* will require details of the ~~firm's~~ *firm's* plans and will discuss them with the *firm* and monitor the winding down or transfer of the *firm's* business. During the period in which it is winding down, a *firm* will also be required to notify the *FSA* of any material changes to the information provided such as, for example, receipt of new complaints and changes to plans.
4.	…
Use of own-initiative powers	
5.	If, for example, the *FSA* has ~~*consumer* protection~~ concerns relating to any of the *regulatory objectives*, it may, however, use its *own-initiative power* under section 45 of the *Act* (Variation etc. on the Authority's own initiative) (see *SUP* 7 (Individual requirements) and *EG* 8 (Variation and cancellation of permission on the *FSA's* own initiative and intervention against incoming firms)) , to vary the *Part IV permission* of a *firm* which is winding down or transferring its *regulated activities*.
…	

…

7.1.5 G By waiving or modifying the requirements of a *rule* or imposing an additional *requirement* or *limitation*, the *FSA* can ensure that the *rules*, and any other *requirements* or *limitations* imposed on a *firm*, take full account of the *firm's* individual circumstances, and so assist the *FSA* in meeting the *regulatory objectives* (for example, to protect *consumers*, ~~and~~ maintain market confidence and contribute to financial stability).

…

7.2.2 G The circumstances in which the *FSA* may vary a *firm's Part IV permission* on its own initiative under section 45 of the *Act* include where it appears to the *FSA* that:

(1) …

(2) it is desirable to vary a *firm's permission* in order to ~~protect the interests of consumers or potential consumers~~ meet any of the *FSA's regulatory objectives*.

…

7.3.4 G The *FSA* will seek to give a *firm* reasonable notice of an intent to vary its *permission* and to agree with the *firm* an appropriate timescale. However, if the *FSA* considers that a delay may ~~be prejudicial to the interest of *consumers*~~ create a risk to any of the *FSA's regulatory objectives*, the *FSA* may need to act immediately using its powers under section 45 of the *Act* to

vary a *firm's Part IV permission* with immediate effect.

…

15.3.1 R A *firm* must notify the *FSA* immediately it becomes aware, or has information which reasonably suggests, that any of the following has occurred, may have occurred or may occur in the foreseeable future:

…

(4) any matter in respect of the *firm* which could result in serious financial consequences to the <u>*UK financial system*</u> or to other *firms*.

…

18.2.2 G The *FSA's regulatory objectives* include market confidence<u>, financial stability</u> and the protection of *consumers*. ~~Either or both~~ <u>Any or all</u> of these might be impaired if a transfer were approved that led to loss, or perceived loss, to *consumers* or other market participants. On the other hand a transfer that led to improved security or benefits for *consumers* would promote the *FSA's regulatory objectives*. When considering a transfer, the *FSA* needs to take into account the interests of existing *consumers* of the transferee and of *consumers* remaining with the transferor as well as of those whose contracts are being transferred. The *guidance* in this section is intended to protect *consumers*. By so doing it promotes the market confidence objective.

…

Sch 2 **Notification requirements**

…

Sch 2.2 G

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
…				
SUP 15.3.1R	Notifications - matters having a serious regulatory impact.	The fact of any of the trigger events occurring.	Becoming aware or having information which reasonably suggests, that any of the following has occurred, may have occurred or may occur in the foreseeable future:	Immediately.
			…	

			(4) any matter in respect of the *firm* which could result in serious financial consequences to the *UK financial system* or to other *firms*.	
…				

Annex I

Amendments to the Compensation sourcebook (COMP)

In this Annex, underlining indicates new text and striking through indicates deleted text.

1.1.9 G This sourcebook is one of the means by which the *FSA* will meet its *regulatory objectives* of securing the appropriate degree of protection for *consumers*, contributing to the protection and enhancement of the financial stability of the *United Kingdom* and maintaining confidence in the *UK financial system*.

…

15.1.1 G When a *relevant person* is *in default* with claims against it for *protected deposits*, it may be desirable for the *FSCS* to make accelerated payments of compensation, for the protection of consumers, to contribute to financial stability and to maintain market confidence.

Annex J

Amendments to the Credit Union sourcebook (CRED)

In this Annex, underlining indicates new text.

14.1.4 G The design of these arrangements is shaped by the *regulatory objectives*. These are set out in section 2 of the *Act* (The Authority's general duties) and are:

(1) maintaining confidence in the *UK financial system*;

(1A) contributing to the protection and enhancement of the stability of the *UK financial system*;

(2) promoting public understanding of the *UK financial system*;

…

…

14.6.4 G The *FSA* may vary a *credit union's Part IV permission* on its own initiative where:

(1) one or more of the *threshold conditions* is, or is likely to be, no longer satisfied;

(2) it is desirable in order to protect members;

(3) it is otherwise desirable in order to meet any of the *FSA's regulatory objectives*.

…

14.9.3 G *SUP* 15.3.1R states that a *credit union* must notify the *FSA* immediately it becomes aware, or has information which reasonably suggests, that any of the following has occurred, may have occurred or may occur in the foreseeable future:

…

(4) any matter in respect of the *credit union* which could result in serious financial consequences to the *UK financial system* or to other *firms*.

…

App 1.1 This is the table referred to in CRED 2.2.2G.

	Sourcebook or manual	**Reference code**
	…	

High Level Standards	The Fit and Proper test for Approved persons	*FIT*
	Financial Stability and Market Confidence sourcebook	*FINMAR*
	…	

Annex K

Amendments to the Electronic Money sourcebook (ELM)

In this Annex, underlining indicates new text and striking through indicates deleted text.

1.2.4 G The *rules* and *guidance* in *ELM* will help the *FSA* to meet the *regulatory objectives* of protecting *consumers*, ~~and~~ maintaining market confidence and protecting financial stability. They do so by setting standards about the backing of *e-money* issued by an *ELMI* with high quality liquid assets. They also do so by setting minimum capital and other risk management standards. This mitigates the risk that *ELMIs* will be unable to meet their liabilities and commitments to *consumers*. *ELM* also protects *consumers* by regulating the relationship between issuers of *e-money* and those who hold their *e-money*.

…

5.4.4 G The risks referred to in *SYSC* 7.1.4R and *SYSC* 7.1.5R relating to *e-money* include the following risks:

…

(4) use of the system referred to in (2) for *financial crime* or in a way that may harm or misuse any part of the *UK financial system*.

…

8.7.9 G The information or documents referred to in *ELM* 8.7.6G must be provided or produced before the end of the reasonable period, and at the place, specified by the *FSA*. The *FSA* may require the information to be provided in such form as it may reasonably require. The *FSA* may require the information to be verified, and the document authenticated, in such manner as it may reasonably require (see article 9G(6) of the *Regulated Activities Order* (Obtaining information from certified persons etc.) and section 165 of the *Act* (Authority's power to require information: authorised persons etc.)) ~~(Obtaining information from certified persons etc.)~~. The *FSA* may use the power to require information and documents from *small e-money issuers* in support of its enforcement functions.

Annex L

Amendments to the Professional Firms sourcebook (PROF)

In this Annex, underlining indicates new text.

1.1.6 G The *rules* and *guidance* in this sourcebook are intended to:

(1) …

(2) promote public understanding of the <u>*UK* </u>*financial system* by ensuring that the *clients* of an *exempt professional firm* are made aware that the firm is not an *authorised person*;

…

Annex M

Amendments to the Recognised Investment Exchanges and Recognised Clearing Houses sourcebook (REC)

In this Annex, underlining indicates new text and striking through indicates deleted text.

2.3.5 G In assessing whether a *UK recognised body* has sufficient financial resources in relation to counterparty and market risks, the *FSA* may have regard to:

(1) the amount and liquidity of its financial assets and the likely availability of liquid financial resources to the *UK recognised body* during periods of major market turbulence or other periods of major stress for the *UK financial system*; and

…

…

2.13.3 G In determining whether a *UK recognised body* is able and willing to promote and maintain high standards of integrity and fair dealing in the carrying on of *regulated activities*, the *FSA* may have regard to the extent to which the *UK recognised body* seeks to promote and encourage, through its rules, practices and procedures, conduct in *regulated activities* which is consistent with the *Code of Market Conduct* (see *MAR* 1) and with any other codes of conduct, rules or principles relating to behaviour in *regulated activities* which users of the *UK financial system* ~~in the *United Kingdom*~~ would normally expect to apply to the *regulated activity* and the conduct in question.

…

3.18.1 G (1) …

…

(3) The information required under *REC* 3.18 is relevant to the *FSA's* supervision of the *UK recognised body's* obligations in relation to the enforceability of compliance with the *UK recognised body's* ~~*rules*~~ rules. It is also relevant to the *FSA's* broader responsibilities concerning market confidence and financial stability~~,~~ and, in particular, its functions in relation to *market abuse* and *financial crime*. It may also be necessary in the case of *members* based outside the *United Kingdom* to examine the implications for the enforceability of *default rules* or collateral and the settlement of transactions, and thus the ability of the *UK recognised body* to continue to meet the *recognition requirements*. It follows that the admission of a *member* from outside the *United Kingdom* who is not an *authorised person* could require notification under both *REC*

3.18.2R and *REC* 3.18.3R, although a single report from the *UK recognised body* covering both notifications would be acceptable to the *FSA*.

…

4.6.4 G Under section 298(7) of the *Act* (Directions and revocation: procedure), the *FSA* need not follow the consultation procedure set out in the rest of section 298 (see *REC* 4.8), or may cut short that procedure, if it considers it essential to do so. The *FSA* is likely to consider it essential to cut short the procedure if, in the absence of immediate action, there would be:

…

(2) a serious threat to market confidence or to the stability of the <u>*UK* *financial system*</u>; or

…

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