HM TREASURY

Implementing the Wheatley Review:

draft secondary legislation

November 2012

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Contents

1 Introduction

1.1 This document introduces and invites comment on the Government's proposed secondary legislation for the implementation of those recommendations outlined in the Wheatley Review of LIBOR, which require legislation.

1.2 LIBOR – or the London Inter-Bank Offered Rate – refers to a series of interest rate benchmarks, which intend to measure the average cost to banks of unsecured borrowing. LIBOR is used as a benchmark in at least $300 trillion-worth of financial contracts, globally.

1.3 Since 2009, the Financial Services Authority (FSA), together with regulators and public authorities in a number of different jurisdictions, has been investigating a number of institutions for alleged misconduct relating to LIBOR and other inter-bank benchmarks. In June of this year, it was revealed that LIBOR had been subject to repeated attempts at manipulation.

1.4 Subsequently, the Chancellor asked Martin Wheatley, CEO-designate of the new Financial Conduct Authority (FCA), to commence an independent review into a number of aspects of the setting and usage of LIBOR. Mr Wheatley presented his findings and recommendations to Government on 28 September 2012: the 10 recommendations are summarised in Box 1.A and the final report can be found on the HM Treasury website.[1]

1.5 The Government endorses every one of Mr Wheatley's recommendations and is committed to implementing the necessary changes to legislation without delay. In particular, the Government has tabled amendments to the Financial Services Bill, which is currently before Parliament, to make the following changes to legislation:

- Amendment to section 22 of, and Schedule 2 to, the Financial Service and Markets Act 2000 ("FSMA") – which sets out the nature of the activities which can be regulated – to allow the specification of benchmark-related activities as regulated activities under FSMA;
- The repeal of section 397 of FSMA – which provides for criminal offences related to the making of misleading statements and practices – and the creation of three criminal offences in relation to misleading statements and impressions: one offence, relating to benchmarks, will be new; the other two offences largely replicate the effect of section 397; and
- An amendment to the powers of the FCA to create a specific power to allow it to make rules requiring authorised persons to contribute to a specified benchmark (e.g. LIBOR). Such rules may refer to the Codes issued in relation to the administration of the benchmark.

1.6 These amendments were tabled in Parliament on 31 October and will be considered by the House of Lords at Report stage of the Financial Services Bill. However, the Government believes

[1] http://cdn.hm-treasury.gov.uk/wheatley_review_libor_finalreport_280912.pdf

that it is necessary to take swift action to reform LIBOR and is therefore seeking views on secondary legislation prior to the Financial Services Bill receiving Royal Assent.

Box 1.A: The recommendations of the Wheatley Review

1. The new Financial Conduct Authority should regulate the submission to, and administration of, LIBOR – and there should be criminal sanctions for any attempted manipulation.
2. The British Bankers' Association should make an orderly transfer of responsibility for LIBOR to a new administrator, selected by an independent committee.
3. The new administrator should scrutinise submissions and regularly review the effectiveness of LIBOR.
4. There should be a new code of conduct for submitters, approved by the Financial Conduct Authority.
5. LIBOR should, as far as possible, be corroborated by transaction data in line with the guidelines in the Review.
6. To improve this ability to corroborate submissions, the number of currencies and maturities for which submissions are made should be cut substantially to achieve a sharper focus on the more heavily-used benchmarks.
7. Individual submissions should be published, but after 3 months to avoid the incentive for banks to try to flatter their perceived credit standing and reduce the opportunity for collusion.
8. The Government should provide the Financial Services Authority with a reserve power to compel banks to submit to LIBOR.
9. All market participants should consider whether LIBOR is the most appropriate rate for their needs and to ensure that their contracts have workable contingency provisions.
10. The UK, European and International Authorities should establish clear principles for global benchmarks.

1.7 The detail of the activities which are to be regulated under FSMA, and the investments, activities and benchmarks to which the new criminal offences apply are all to be set out in secondary legislation. This document invites comments on two key pieces of secondary legislation: the Order to be made under section 22 FSMA, as amended by the Financial Services Bill, to amend the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 and the Order to be made under the new provisions of the Financial Services Bill which create new criminal offences.

1.8 The Government proposes in this consultation document to bring the series of interest rate benchmarks known as the London Inter-Bank Offered Rate, or LIBOR, within the scope of regulation and to specify LIBOR as the relevant benchmark to which the new criminal offence applies.

1.9 However, the amendments to the Financial Services Bill also make it possible for the Government to act quickly to bring additional benchmarks within the scope of regulation, and to extend the list of benchmarks for which the new criminal offence apply, should this prove necessary.

1.10 Detailed information on this secondary legislation is set out in the chapters below and drafts of the statutory instruments are set out in Annexes B and C. The relevant provisions of the Financial Services Bill are available to view on the Parliamentary website.[2]

1.11 HM Treasury have produced an impact assessment, which sets out the likely costs and benefits of the regulatory intervention that this proposed secondary legislation will result in. A copy of the impact assessment is contained in Annex D.

Box 1.B: Consultation question

1 Do you have views on the assessment of the likely impact of these draft amendments, as outlined in Annex D?

Next steps

1.12 The consultation on these pieces of secondary legislation will be open for a period of 4 weeks until 24 December 2012. Responses should either be posted to the Financial Regulation Strategy team, HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ, or emailed to financial.reform@hmtreasury.gsi.gov.uk.

1.13 The Government envisages the Financial Services Bill receiving Royal Assent in late 2012 or early 2013. The secondary legislation included in this document (amended as appropriate following this consultation) will then be laid in draft before Parliament as early as possible in 2013, subject to the Parliamentary timetable.

1.14 The FSA will in due course, begin a public consultation on the structure of the supervisory regime for benchmark-related activities. This will include the writing of any necessary Handbook rules and guidance, as well as the introduction of controlled functions for these activities.

1.15 Chapter 2 of this document discusses the specification of LIBOR activities as regulated activities and the associated transitional provisions; Chapter 3 discusses the statutory instrument which specifies the investments, activities and benchmarks for the criminal offences under FSMA; and Chapter 4 discusses the potential for additional benchmarks to be added to the list of regulated benchmarks and to be added to the list of relevant benchmarks for which the new criminal offence applies.

[2] http://www.publications.parliament.uk/pa/bills/lbill/2012-2013/0048/amend/ml048-i.htm

2 Regulated activities

2.1 This chapter discusses the proposed secondary legislation that will implement the recommendation in the Wheatley Review that the setting of LIBOR and the administration of LIBOR should become regulated activities.

2.2 The Financial Services Bill creates a regulatory regime based on separate prudential and conduct of business regulators; the Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA). In order to carry out a regulated activity, a firm is required to either seek authorisation from the appropriate regulator (PRA/FCA) or be exempt.

2.3 Regulated activities will be subject to conduct regulation in all cases by the FCA and prudential regulation by the PRA if the person carrying it out is a PRA-regulated firm. However, the Government does not consider activities in respect of benchmarks, if carried on in isolation, as requiring prudential supervision by the PRA and hence is not proposing to specify these activities as PRA-regulated activities.

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

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

2.5 Collectively, these changes will result in a clear and robust regulatory regime, which should in turn lead to the restoration of credibility and confidence in LIBOR, as outlined in the Wheatley review. The FSA will consult on any Handbook rules and guidance that it intends to make in this area, as well as the creation of controlled functions for LIBOR activities, shortly.

2.6 Amendments to the Financial Services Bill to make these necessary changes were tabled by the Government on 31 October this year.

2.7 The proposed amendments to the Financial Services Bill extends section 22 of, and Schedule 2 to, FSMA – which collectively set out the nature of the activities which can be regulated – to allow inclusion of benchmark-related activities as regulated activities.

2.8 Section 22 of FSMA provides that HM Treasury may specify, by way of an Order, which activities are regulated activities. The subject of this chapter of the consultation paper is the draft Order to create new regulated activities concerning benchmarks, such as LIBOR.

Amendments to the Regulated Activities Order

Regulated activities

2.9 Regulated activities are specified in the Financial Services and Markets Act 2000 (Regulated Activities) Order ("RAO")[1]. HM Treasury proposes making changes to the RAO, which will specify activities connected with a regulated benchmark as regulated activities. The draft amendments to the RAO are contained in Annex B.

2.10 The draft Order proposes two new regulated activities, as recommended by the Wheatley review, which are defined as: i) providing information in relation to a regulated benchmark; and ii) administering a regulated benchmark.

2.11 In particular, "providing information" in relation to a regulated benchmark means:

- providing any information, including expressions of opinion, that is required in connection with and for the purpose of, the determination of a regulated benchmark.

2.12 "Administering" a regulated benchmark includes a number of aspects:

- administering the arrangements for determining a regulated benchmark;
- collecting, analysing, or processing information for the purpose of determining a regulated benchmark; and
- determining a regulated benchmark, through the application of a formula or other calculation method, to the information or expression of opinion provided, in order to achieve the final regulated benchmark.

Regulated benchmarks

2.13 The draft amendments to the RAO also contain a new schedule, schedule 5, which specifies the benchmarks that are regulated for the purpose of the new activities. At present the only benchmarks specified are the series of interest rate benchmarks known as the London Inter-Bank Offered Rate, or LIBOR.

2.14 Chapter 4, below, discusses the possible addition of other benchmarks to the list of regulated benchmarks, by way of further amendments to the Regulated Activities Order.

Exemption provisions

2.15 The draft amendments also outline provisions where certain similar activities are not regarded as regulated activities. In particular, where persons who may provide information in relation to a regulated benchmark, but that information is:

- factual and obtained from a publically available source, for example, information from an internet search engine; and
- compiled by a subscription service for other purposes than in connection with the determination of a regulated benchmark, for example, data obtained from financial data service companies.

2.16 A second exemption provides for a contingency scenario in which the FCA is required to administer a regulated benchmark, for the purpose of meeting its objectives to protect the

[1] S.I.2001/544

interests of consumers and maintain market integrity. In this case, the FCA would not be considered as carrying on that regulated activity.

Transitional provisions

2.17 Prior to the commencement of the revised RAO, existing firms will already be carrying on both the activities that will become regulated activities. That is, banks already providing information to LIBOR in the form of daily submissions will continue to do so; and a firm will already have responsibility for administering LIBOR.[2]

2.18 Once benchmark activities become regulated activities in relation to LIBOR, upon commencement of the Order, the firms contributing to, and administering, LIBOR will need to be authorised and will require a Part 4A permission to carry on those activities.

2.19 In order to deal with the short timetable involved in the transition of LIBOR to a regulatory framework and at the same time ensuring the continued publication of LIBOR, there are two sets of transitional provisions proposed in the draft RAO:

- to deem current LIBOR-submitting banks as having the necessary permission to provide information to the benchmark; and
- to grant an interim permission to the administrator of LIBOR.

2.20 Firstly, the draft Order provides that, provided that they already hold a Part 4A permission, firms who currently make LIBOR submissions to LIBOR are deemed to also have the necessary permission to provide information to LIBOR as the regulated benchmark.

2.21 The Government believes that it is necessary to deem banks as having the relevant permission to avoid the risk of a further erosion of the standing of LIBOR through reduced participation by banks. Banks currently contribute to LIBOR on a voluntary basis. The recent revelations of attempted manipulation of LIBOR will have led to negative publicity for banks contributing to LIBOR, which in turn, will have further weakened the individual incentives for firms to participate in the LIBOR process. Requiring banks to submit applications for a formal variation of permission could trigger a decline in participation in LIBOR contributions which would further threaten LIBOR.

2.22 There are risks associated with deeming banks as automatically having the relevant permission given the potential outcome of ongoing enforcement action by the FSA and other international bodies. The Government acknowledges these risks, but is assured that the FCA will conduct a comprehensive thematic review of firm systems and controls for LIBOR within one year of the introduction of the FCA's LIBOR supervisory regime.

2.23 Secondly, the draft Order grants the administrator of LIBOR a Part 4A permission for an interim period upon commencement of the Order, conditional on submitting an application by a set date. This interim permission will last until such time as their application has been approved by the appropriate regulator as defined in FSMA. In the case of a variation of existing permission this will be the FCA, unless the firm is a PRA-authorised person when approval will be by the PRA.

2.24 The Government believes it is necessary to grant an interim permission for the LIBOR administrator for two reasons.

2.25 First, the rate administrator who succeeds the BBA may not already be an authorised person. Consequently, the rate administrator may not have been subject to the FCA or PRA's

[2] At the time of consultation, the British Bankers Association (BBA) administers LIBOR. However, in accordance with Recommendation 2 of the Wheatley Review, upon commencement of the RAO, it is envisaged that a new body will be responsible for the administration of LIBOR.

usual assessments on firms seeking to carry on regulated activities. Whilst the administrator will need to have permission to carry on the activity from the date of commencement of the Order, the interim nature of the permission given in the Order ensures that the administrator remains subject to the usual assessment procedures for granting a Part 4A permission.

2.26 Second, even if the rate administrator succeeding the BBA is already an authorised person, the administrator will be taking on a new task, unlike those submitting to LIBOR who are carrying out activities they have already been doing. It is therefore appropriate that an already authorised administrator should have to apply for a variation of permission and that this request should be assessed according to the FCA or PRA's usual procedures before a final part 4A permission is granted.

Box 2.A: Consultation questions

2 Do you have views on the definition and scope of the proposed regulated activities, including the draft exception provisions, in the draft Regulated Activities Order?

3 Do you agree that the specification in Schedule 5 of the draft Regulated Activities Order is an accurate description of LIBOR?

4 Do you have views on the proposed transitional provisions contained in the draft Regulated Activities Order?

3 FSMA offences

3.1 This chapter discusses the draft secondary legislation that underpins the new criminal offences being created in the Financial Services Bill, which implement the recommendation in the Wheatley Review that there should be sufficient criminal sanctions for misconduct in relation to benchmarks, in order that the FCA can investigate and prosecute such behaviour.

3.2 The FCA will have statutory powers of investigation with respect to various offences under FSMA, including the making of misleading statements and practices under section 397 of FSMA, and other offences such as insider dealing. However, the FCA will have no powers to investigate the suspected commission of an offence under the Fraud Act 2006.

3.3 While LIBOR misconduct may fall within the scope of other criminal offences, it is important that the FCA, as the body responsible for the supervision of conduct in the financial services sector, is able to conduct effective criminal investigations and prosecutions in this area. Indeed, there are also merits in the creation of a specific criminal offence that relates specifically to misconduct in relation to the setting of financial benchmarks.

3.4 The creation of a criminal offence relating to LIBOR misconduct requires changes to both primary and secondary legislation. Amendments to the Financial Services Bill were tabled by the Government on 31 October this year alongside those outlined above.

3.5 The amendments will repeal section 397 of FSMA and create three criminal offences in the Financial Services Bill itself.

- The first offence largely replicates the existing offence in the existing section 397(2) of FSMA, but with modernised language: the making of false or misleading statements for the purpose of inducing (or being reckless as to whether it may induce) another person to engage in market activity in relation to specified investments.
- The second offence largely replicates the existing offence in section 397(3): the creation of a false or misleading impression with a view to inducing another person to engage in market activity in relation to specified investments. The second offence also creates a new offence of creating such an impression with a view to making a profit, or avoiding a loss in relation to specified investments.
- The third offence is new and relates to the making of false or misleading statements, or the creation of false or misleading impressions in relation to specified benchmarks (such as LIBOR).

3.6 The amendments to the Financial Services Bill provide that HM Treasury may specify, by way of an Order, the activities, investments and benchmarks to which these offences relate. The subject of this consultation paper is the draft Order which specifies those investments, activities and benchmarks.

The draft Order

Relevant agreements, relevant activities and relevant investments

3.7 The first offence relating to the making of false or misleading statements, is only committed if the statement is made with the intention of, or being reckless as to whether, another person is induced to enter into, offer to enter into, or refrain from so entering into or offering to enter into, a "relevant agreement" or to exercise or refrain from exercising any rights conferred by a "relevant investment". "Relevant agreement" is defined as an agreement the entering into or performance of which constitutes an activity specified by HM Treasury and which relates to a relevant investment.

3.8 "Relevant investment" is also a concept which is relevant to the second offence relating to misleading impressions. The offence only applies where a person does any act or engages in any course of conduct which creates a false or misleading impression as to the market in or the price or value of any relevant investment.

3.9 These aspects of the new criminal offences closely reflect the approach taken in section 397 FSMA.

3.10 The draft Order at Annex C specifies that all controlled investments within the meaning of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005[1] ("the Financial Promotion Order") are "relevant investments" for the purposes of these offences. This means that the scope of the offences reflects the scope of the criminal offence under section 21 FSMA (restrictions on financial promotions by unauthorised persons).

3.11 The draft Order specifies as "relevant activities" those activities which are "controlled" activities for the purposes of the Financial Promotion Order. It also specifies certain activities specified in the Regulated Activities Order, namely: sending dematerialised instructions, establishing a collective investment scheme, establishing a stakeholder pension scheme and managing the underwriting capacity of a Lloyd's syndicate. The draft Order also specifies certain activities in relation to contracts of insurance.

3.12 These aspects of the draft Order replicate the effect of the Financial Services and Markets 2000 (Misleading Statements and Practices) Order 2001[2].

Relevant benchmarks

3.13 The amendments to the Financial Services Bill create a new criminal offence relating to the making of false or misleading statements, or the creation of false or misleading impressions in relation to "relevant benchmarks". The benchmarks which are relevant to this new offence are specified in secondary legislation.

3.14 The draft Order lists the relevant benchmarks, which for now will be LIBOR only. However, chapter 4 discusses the potential for additional benchmarks to be added to the list of relevant benchmarks for which the new criminal offence applies, by way of amendments to this Order.

Box 3.A: Consultation question

5 Do you have any views on the content of the new 'misleading statements' Order?

[1] SI 2005/1529.
[2] SI 2001/3645.

4 Other benchmarks

4.1 As the previous chapters have outlined, the Government considers that the benchmarks known as LIBOR, should be: firstly, brought within the scope of regulation; and secondly, be the relevant benchmark for which the proposed new criminal offence applies.

4.2 However, the amendments to the Financial Services Bill will make it possible for the Government to bring additional benchmarks within the scope of regulation, and to extend the list of benchmarks to which the new criminal offence apply, should this prove necessary.

International benchmark reform

4.3 Subsequent to the publication of the Wheatley Review, a number of international initiatives have begun, examining the production and use of benchmarks. The Financial Stability Board is playing a co-ordinating role across the following international initiatives examining benchmark reform more widely:

- The International Organization of Securities Commissions (IOSCO) Board Level Task Force on Financial Market Benchmarks (co-chaired by the FSA) is developing global policy guidance and principles for benchmark-related activities. IOSCO intends to publish a consultation paper soon and the work is expected to complete by Spring 2013;
- The Bank for International Settlements (BIS) Governors have agreed to set up a group of senior officials to take forward examination of reference rates used in financial markets, and to consult with the market in order to provide input into the wider official debate coordinated by the Financial Stability Board;
- The European Commission is consulting on a possible framework for the regulation of the production and use of indices serving as benchmarks in financial and other contracts; and
- The European Securities and Markets Authority (ESMA) intend to produce interim principles for benchmarks while the Commission's work develops.

Assessment of other benchmarks

4.4 As part of its final report, the Wheatley Review made a recommendation that the FSA examine other important benchmarks, and where appropriate apply the recommendations of the Wheatley Review alongside other internationally agreed principles.

4.5 The Government believes that assessments by the FSA of other benchmarks should consider the perimeter of regulation and the suitability of a specific criminal offence taking into account (where relevant) any evidence of abusive behaviour in relation to a particular benchmark. Where appropriate, recommendations should be made to HM Treasury as to necessary amendments to the scope of regulation and the scope of the criminal offence.

4.6 At present, the Government considers that the initial benchmarks that should be brought within the scope of regulation or the scope of the new criminal offence are LIBOR. However,

further benchmarks may need to be added to these Orders, should it become clear that to do so would bridge a gap in the regulatory or enforcement powers of the regulatory authorities. Additional benchmarks could include, if appropriate, benchmarks reflecting energy or commodity markets.

Box 4.A: Consultation question

6 Do you have views as to whether the Government should specify benchmarks other than LIBOR as regulated benchmarks and/or specify benchmarks other than LIBOR as relevant benchmarks for the purposes of the new criminal offence?

A Consultation questions

A.1 The following box lists the consultation questions posed in this document.

Box A.1: Consultation questions

1. Do you have views on the assessment of the likely impact of these draft amendments, as outlined in Annex D?
2. Do you have views on the definition and scope of the proposed regulated activities, including the draft exception provisions, in the draft Regulated Activities Order?
3. Do you agree that the specification in Schedule 5 of the draft Regulated Activities Order is an accurate description of LIBOR?
4. Do you have views on the proposed transitional provisions contained in the draft Regulated Activities Order?
5. Do you have any views on the content of the new 'misleading statements' Order?
6. Do you have views as to whether the Government should specify benchmarks other than LIBOR as regulated benchmarks and/or specify benchmarks other than LIBOR as relevant benchmarks for the purposes of the new criminal offence?

B Draft Regulated Activities Order

B.1 The following pages contain the draft amendments to the Regulated Activities Order.

Draft Order laid before Parliament under section 22 and Schedule 2 of the Financial Services and Markets Act 2000, for approval by resolution of each House of Parliament.

STATUTORY INSTRUMENTS

2013 No.

FINANCIAL SERVICES

The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2013

Made - - - -	***
Laid before Parliament	***
Coming into force in accordance with article 1(2)	

In the opinion of the Treasury, one of the effects of the following order is that an activity which is not a regulated activity (within the meaning of the Financial Services and Markets Act 2000(**a**)) will become a regulated activity.

The Treasury, in exercise of the powers conferred by sections 22(1A) and (5), 426, 427 and 428(3) of, and paragraph 25 of Schedule 2 to, the Financial Services and Markets Act 2000 make the following Order:

PART 1

GENERAL

Citation and commencement

1.—(1) This Order may be cited as the Financial Services and Markets Act 2000 (Regulated Activities)(Amendment) Order 2013.

(2) This Order comes into force—

(a) for the purposes of making an application for a Part 4A permission in relation to activities of the kind specified by article 63O(1)(b) of the Principal Order on [date];

(b) for all other purposes on [date].

Interpretation

2. In this Order—

"the Act" means the Financial Services and Markets Act 2000,

"the FCA" means the Financial Conduct Authority,

(**a**) 2000 c.8

"the general commencement date" means the date in article 1(2)(b),

"the PRA" means the Prudential Regulation Authority,

"the Principal Order" means the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001(**a**)

PART 2

AMENDMENTS OF PRIMARY LEGISLATION

Amendments of the Financial Services and Markets Act 2000

3.—(1) The Act is amended as follows.

(2) In section 1G (meaning of "consumer"), in subsection (1) —

(a) at the end of paragraph (c) omit "or";

(b) at the end of paragraph (d) insert ", or

(e) have rights, interests or obligations that are affected by the level of a regulated benchmark.".

(3) In section 1H (further interpretative provisions for sections 1B to 1G), after subsection (7) insert—

"(7A) "Regulated benchmark" means a benchmark, as defined in section 22(6), in relation to which any provision made under section 22(1A)(b) has effect.".

(4) In section 425A (consumers: regulated activities etc carried on by authorised persons)—

(a) at the end of subsection (2)(a), omit "or";

(b) at the end of subsection (2)(b), insert "or

(c) whose rights, interests or obligations are affected by the level of a regulated benchmark.";

(c) in subsection (7) after "in an EEA State;", insert—

""regulated benchmark" means a benchmark, as defined in section 22(6), in relation to which any provision made under section 22(1A)(b) has effect.".

PART 3

AMENDMENTS OF THE REGULATED ACTIVITIES ORDER

Amendment of the Principal Order

4.The Principal Order is amended as follows.

Definitions

5. In article 3(1) (interpretation), after the definition of "qualifying contract of insurance" insert—

""regulated benchmark" has the meaning given by article 63O(2);"

Regulated benchmarks

6. After article 63N insert—

(**a**) S.I. 2001/544 to which there are amendments not relevant to this Order.

"CHAPTER 15E

REGULATED BENCHMARK ACTIVITIES

The activities

Regulated benchmarks

63O.—(1) The following are specified kinds of activity—

(a) providing information in relation to a regulated benchmark;

(b) administering a regulated benchmark.

(2) In this Chapter—

(a) a "regulated benchmark" is a benchmark specified in Schedule 5 to this Order.

(b) "providing information" in relation to a regulated benchmark means providing any information or expression of opinion that is

(i) provided to, or for the purposes of passing to, a person who has permission to carry out the activity specified in paragraph (1)(b) in relation to that regulated benchmark, and

(ii) required in connection with the determination of the regulated benchmark, and

(iii) provided for that purpose.

(c) "administering" a regulated benchmark means—

(i) administering the arrangements for determining a regulated benchmark, or

(ii) collecting, analysing or processing information or expressions of opinion for the purpose of the determination of a regulated benchmark, or

(iii) determining a regulated benchmark through the application of a formula or other method of calculation to the information or expressions of opinion provided for that purpose.

Exclusions – providing information

63P. A person does not carry on an activity of the kind specified by article 63O(1)(a) in relation to a regulated benchmark where that information—

(a) consists solely of factual data obtained from a publicly available source, or

(b) is compiled by a subscription service for purposes other than in connection with the determination of a regulated benchmark and is provided to a person who has permission to carry on an activity of the kind specified by article 63O(1)(b) only in that person's capacity as a subscriber to the service.

Exclusions – the FCA

63Q. The FCA does not carry out the activity of the kind specified by article 63O(1)(b) in relation to a regulated benchmark where the FCA administers the regulated benchmark itself. "

Schedule

7. After Schedule 4, insert—

“SCHEDULE 5

REGULATED BENCHMARKS

1. The benchmarks that are known as the London Interbank Offered Rate, also known as LIBOR.”

PART 4

TRANSITIONAL PROVISIONS

Transitional provisions

8.—(1) Paragraph (2) applies to a person (“A”) who, immediately before the date of general commencement—

(a) had a Part 4A permission; and

(b) was providing any information or expression of opinion to the administrator of a benchmark listed in Schedule 5 of the Principal Order that the administrator required in connection with the determination of the benchmark and was provided by A for that purpose.

(2) A is to be treated as having, on the date of general commencement, a Part 4A permission to carry on the activity specified in article 63O(1)(a) of the Principal Order as amended by this Order.

(3) For the purposes of this article the administrator of a benchmark listed in Schedule 5 is a person who immediately before commencement was—

(a) administering the arrangements for determining the listed benchmark, or

(b) collecting, analysing or processing information or expressions of opinion for the purpose of determining the listed benchmark, or

(c) determining the listed benchmark through the application of a formula or other method of calculation to the information or expressions of opinion provided for that purpose.

Interim permission

9.—(1) This article applies where—

(a) a person (“B”) has submitted an application for a Part 4A permission or a variation of a Part 4A permission, to the relevant Authority to carry on the activity specified in article 63O(1)(b) of the Principal Order as amended by this Order;

(b) the relevant Authority received the application on or before [date]; and

(c) the application has not been finally decided before the date of general commencement.

(2) B is to be treated as having at the date of general commencement the permission to which the application relates.

(3) A permission which B is to be treated as having is referred to in this Order as an “interim permission”.

(4) Without prejudice to the exercise by the relevant Authority of its powers under Part 4A of the Act an interim permission lapses when the application has been finally decided.

(5) In this article “finally decided” means—

(a) subject to paragraph (6), when the application is withdrawn;

(b) when the relevant Authority grants permission to carry on the activity in question under—

(i) section 55E of the Act (giving permission: the FCA), or

(ii) section 55F of the Act (giving permission: the PRA), or

(iii) section 55H of the Act (variation by FCA at request of an authorised person), or

(iv) section 55I of the Act (variation by PRA at request of an authorised person);

(c) where the relevant Authority has refused an application and the matter is not referred to the Tribunal, when the time for referring the matter to the Tribunal has expired;

(d) where the relevant Authority has refused an application and the matter is referred to the Tribunal when—

(i) if the reference is determined by the Tribunal, the time for bringing an appeal has expired, or

(ii) on an appeal from a determination by the Tribunal on a point of law, the Court itself determines the application.

(6) B may not withdraw the application within first obtaining the consent of the relevant Authority.

(7) The "relevant Authority" for the purposes of this article means—

(a) Before 1 April 2013 the Financial Services Authority

(b) After 1 April 2013,

(i) in the case of an application under section 55A of the Act (application for permission), the appropriate regulator as defined in subsection (2) of that section, and

(ii) in all other cases, the FCA, unless B is a PRA-authorised person, in which case the relevant Authority is the PRA.

Application of the FCA's rules etc to persons with interim permission

10.—(1) The FCA may direct in writing that any relevant provision which would otherwise apply to a person by virtue of an interim permission is not to apply, or is to apply to that person as modified in the way specified in the direction.

(2) Where the FCA makes a rule, gives guidance or issues a statement or code which applies only to persons with an interim permission (or only to a class of such persons), sections 63D (statement of policy: procedure), 65 (statements and codes: procedure) and 138I (consultation by the FCA) and subsection (3) of section 139A (power of the FCA to give guidance) of the Act do not apply to that rule, guidance, statement or code.

(3) For the purposes of paragraph (1), a "relevant provision" is any provision made as a result of the exercise by the FCA of any of its legislative functions mentioned in paragraph 8(3) of Schedule 1ZA to the Act (the Financial Conduct Authority).

Application of the Act to persons with an interim permission

11.—(1) This article applies to every person with interim permission.

(2) A person with an interim permission is to be treated on or after [date of full commencement] as an authorised person for the purposes of the Act (and any provision made under the Act), unless otherwise expressly provided for by this article.

(3) For the purpose of section 20 (authorised persons acting without permission), a person's interim permission is treated as having been given to him under Part 4A of the Act.

(4) A person's interim permission is to be disregarded for the purposes of—

(a) section 38(2) (exemption orders);

(b) section 55A(3) (application for permission);

(c) section 55E (giving permission: the FCA);

(d) section 55F (giving permission: the PRA);

(e) section 55H (variation by FCA at request of an authorised person);

(f) section 55I (variation by PRA at request of an authorised person);

(g) section 55L (imposition of requirements by FCA); and

(h) section 55M (imposition of requirements by PRA).

XXXXXX
XXXXXX

[XXXX 2013] Two of the Lords Commissioners of Her Majesty's Treasury

EXPLANATORY NOTE

(This note is not part of the Order)

This Order amends the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 ("the Principal Order") so as to specify new regulated activities. The Principal Order specifies kinds of activities and investments for the purposes of the Financial Services and Markets Act 2000 (c.8) ("the Act"). The matters with respect to which regulated activities may be specified include activities relating to the setting of benchmarks (paragraphs 24E to H of Schedule 2 to the Act, inserted by the Financial Services Act 2012 (c.x)). This Order specifies the activities of providing information in relation to and administering a regulated benchmark.

Article 3 of the Order makes consequential amendments to sections 1G, 1H and 425A of the Act to adjust the definition of a consumer in order that the consumer protection objective applies with regard to the new regulated activities and so that those affected by the carrying on of the new regulated activities may benefit from the provisions in the Act to protect consumers.

Articles 4 to 7 of the Order insert a new definition, a new article and a new schedule into the Principal Order to specify the new regulated activities and to set out what are regulated benchmarks.

Article 8 of the Order provides for a Part 4A permission to be deemed to be extended to those firms who immediately before commencement of this Order were already carrying on the activity of providing information to the administrator of a benchmark listed in Part 1 of Schedule 5 to the Principal Order that was required for the determination of that benchmark and who already had a Part 4A permission.

Article 9 provides for an interim permission to be granted to persons wishing to undertake administering, determining or publishing activities, provided that they have lodged an application with the relevant regulator by [date].

Article 10 enables the regulator to modify amongst other things, its rules in their application to persons with an interim permission.

Article 11 sets out the application of the Act to persons with interim permission.

An Impact Assessment of the effect of this instrument on the costs of business has been prepared and is available on HM Treasury's website (hm-treasury.gov.uk) or from the [team] HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ and is published with the Explanatory Memorandum alongside this Order on the legislation.gov.uk website (Legislation.gov.uk)

C Draft ‘misleading statements’ Order

C.1 This Annex contains the draft ‘misleading statements’ Order.

CONSULTATION DRAFT

*Draft Order laid before Parliament under section *** of the Financial Services Act 201*, for approval by resolution of each House of Parliament.*

D R A F T S T A T U T O R Y I N S T R U M E N T S

2013 No.

FINANCIAL SERVICES AND MARKETS

The Financial Services Act 201* (Misleading Statements and Impressions) Order 201*

Laid before Parliament in draft

This is the first order made under section *** of the Financial Services Act 201*.

The Treasury, in exercise of the powers conferred by sections *** and [104] of the Financial Services Act 201*(**a**), makes the following Order:

Citation, commencement and interpretation

1.—(1) This Order may be cited as the Financial Services Act 201* (Misleading Statements and Impressions) Order 201* and comes into force on [1 April 2013].

(2) In this Order—

"the Act" means the Financial Services Act 201*;

"contract of insurance" has the meaning given by article 3(1) of the Regulated Activities Order;

"controlled activity" means an activity which falls within Part I of Schedule 1 to the Financial Promotion Order(**b**);

"controlled investment" means an investment which falls within Part II of Schedule 1 to the Financial Promotion Order(**c**);

"the Financial Promotion Order" means the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005(**d**);

"the Regulated Activities Order" means the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001(**e**).

(**a**) 201* c.*.
(**b**) Amended by SI 2006/2383, SI 2006/3384 and SI 2009/1342.
(**c**) Amended by SI 2006/1969, SI 2006/2383, SI 2006/3384, SI 2009/1342, SI 2010/86, SI 2011/133.
(**d**) SI 2005/1529.
(**e**) SI 2001/544.

Relevant agreements – specified kinds of activity

2.The following kinds of activity are specified for the purposes of section *(3)(a) of the Act (Interpretation of Part 6A)—

(a) a controlled activity;

(b) agreeing to carry on an activity which falls within any of the following provisions of Schedule 1 to the Financial Promotion Order—

(i) paragraph 9 (providing funeral plan contracts);

(ii) paragraph 10 (providing qualifying credit);

(iii) paragraph 10A (arranging qualifying credit); or

(iv) paragraph 10B (advising on qualifying credit);

(c) an activity of the kind specified by any of the following provisions of the Regulated Activities Order—

(i) article 45 (sending dematerialised instructions)(**a**);

(ii) article 51 (establishing etc a collective investment scheme);

(iii) article 52 (establishing etc a stakeholder pension scheme)(**b**); or

(iv) article 57 (managing the underwriting capacity of a Lloyd's syndicate);

(d) (so far as not already specified by paragraph (a)) an activity of the kind specified by any of the following provisions of the Regulated Activities Order—

(i) article 14 (dealing in investments as principal)(**c**),

(ii) article 21 (dealing in investments as agent)(**d**),

(iii) article 25(1) or (2) (arranging deals in investments)(**e**),

(iv) article 39A (assisting in the administration and performance of a contract of insurance)(**f**),

(v) article 53 (advising on investments)(**g**), or

(vi) so far as relevant to any of those articles, article 64(**h**),

so far as it relates to a contract of insurance.

Relevant investments

3. Controlled investments are specified for the purposes of section *(5) of the Act.

Relevant benchmarks

4.The benchmarks that are known as the London Interbank Offered Rate (also known as LIBOR) are specified for the purposes of section *(4) of the Act.

Name
Name
Two Lords Commissioners of Her Majesty's Treasury

(**a**) Amended by SI 2002/682.
(**b**) Amended by SI 2006/1969.
(**c**) Amended by SI 2006/3384.
(**d**) Amended by SI 2003/1476 and SI 2006/3384.
(**e**) Amended by SI 2003/1476 and SI 2006/3384.
(**f**) Inserted by SI 2003/1476.
(**g**) Amended by SI 2003/1476.
(**h**) Amended by SI 2002/682, SI 2006/3384 and SI 2009/1389.

EXPLANATORY NOTE

(This note is not part of the Order)

This Order specifies relevant activities,, relevant investments and relevant benchmarks for the purposes of Part [6A] of the Financial Services Act 201*. This Part creates criminal offences which relate to the making of false or misleading statements, or the creation of a false or misleading impression, in connection with a relevant agreement, relevant investment or relevant benchmark.

Article 2 specifies activities which are relevant for the purposes of the definition of "relevant agreement" which is used in section * (misleading statements).

Article 3 specifies investments which are "relevant investments". This concept is relevant for the purposes of section * (misleading statements) and section * (misleading impressions).

Article 4 specifies the benchmarks which are "relevant benchmarks" for the purposes of section * (misleading statements etc in relation to benchmarks).

D Impact assessment

D.1 The following pages contain the impact assessment for this consultation.

Title: Wheatley Review of LIBOR: Implementation **IA No:** **Lead department or agency:** HM Treasury **Other departments or agencies:** Financial Services Authority	**Impact Assessment (IA)** **Date:** 05/10/2012 **Stage:** Final **Source of intervention:** Domestic **Type of measure:** Secondary legislation **Contact for enquiries:** financial.reform@hmtreasury.gsi.gov.uk

Summary: Intervention and Options

RPC Opinion: GREEN

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
£-95.75m	£-92.31m	£10.72m	No	NA

What is the problem under consideration? Why is government intervention necessary?

Since 2009, the Financial Services Authority (FSA) and regulators in several jurisdictions have been investigating a number of institutions for alleged manipulation of LIBOR.
In response, the Government commissioned an independent review of LIBOR led by Martin Wheatley, Managing Director FSA and CEO-designate FCA.
A conclusion of the Review was that self-regulation of LIBOR has failed. In particular, it consisted of insufficient incentives and procedures to ensure that the benchmark was beyond reproach.

What are the policy objectives and the intended effects?

LIBOR reform is a priority issue for the Government and is vital in order to secure continuing market confidence and financial stability, which in turn is good for UK financial services and consumers. Recent revelations in relation to LIBOR have shattered confidence in one of the most important benchmarks in the world of finance and tarnished the image of the City. The policy objective of the suggested policy proposals is therefore to fully restore credibility in LIBOR as one of the most widely used and systemically important financial benchmarks (referenced in at least $300tn worth of contracts globally).

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Option (1): 'Do nothing'. The Wheatley Review concluded that the self-regulation model for LIBOR had failed, and that the systems and controls around LIBOR need comprehensive reform if LIBOR is to continue as an important financial benchmark. Further, given the large stock of outstanding transactions that reference LIBOR and the lack of viable alternative benchmarks, the wholesale replacement of LIBOR does not appear to be feasible. Therefore the 'do nothing' option is unlikely to be an attractive option.
Option (2): Implement the Wheatley Review recommendations. These recommendations propose strengthening the existing governance and setting framework for LIBOR. In particular, the Review recommended that the best way to do this would be to: i) make LIBOR submission and administration regulated activities under FSMA; ii) introduce criminal sanctions in relation to attempted manipulation of LIBOR, and iii) provide the FSA with rule-making power in relation to LIBOR.

Will the policy be reviewed? It will not be reviewed. **If applicable, set review date:** Month/Year

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** No	**< 20** No	**Small** No	**Medium** No	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: Greg Clark Date: 6/10/2012

Summary: Analysis & Evidence — Policy Option 1

Description: Amending the Financial Services and Markets Act (FSMA) and relevant statutory instruments to make contributing to, and administration of, LIBOR regulated activities and attempted manipulation of benchmarks a criminal offence.

FULL ECONOMIC ASSESSMENT

Price Base Year 2012	PV Base Year 2012	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:** -95.75

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional		Optional	**Optional**
High	Optional	1	Optional	**Optional**
Best Estimate	£39.8m		£6.5m	**£95.75m**

Description and scale of key monetised costs by 'main affected groups'

The main affected groups are contributing banks, the LIBOR administrator and the regulator (the FSA/FCA). The majority of the costs fall on contributing banks - through staff and IT costs for compliance with regulation - amounting to around £38m of transitional costs, and £5.8m a year ongoing. Some costs will be borne by the administrator of LIBOR - in particular £1.6m of transitional costs and £0.3m a year of ongoing costs. The costs to the regulator are estimated at around £0.4m per year

Other key non-monetised costs by 'main affected groups'

None.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	N/A		N/A	**N/A**

Description and scale of key monetised benefits by 'main affected groups'

None.

Other key non-monetised benefits by 'main affected groups'

LIBOR is used in contracts worth over $300tn. Implementation of the Wheatley Review recommendations should result in a LIBOR framework that is signficantly less vulnerable to attempted manipulation and subject to much stronger governance and regulatory oversight. As a consequence it would avoid disorderly breakdown, LIBOR will have substantially more credibility and integrity among authorities, market participants and the public, and can therefore continue to serve as an important financial benchmark.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

Costs are based on estimates of IT and staff costs, which in turn are based on a Hudson Banking & Financial Services Salary Guide 2012, Hudson Legal Salary Survey 2011, Russell Reynolds Chairmen and Non-Executive Director Survey 2011, and FSA staff and IT cost estimates.Costs for contributing banks are intended to be estimates for a typical panel bank, but may vary depending on the current state of bank systems and the number of LIBOR panels that banks contribute to.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: £10.7m	**Benefits:** N/A	**Net:** N/A	No	NA

Evidence Base (for summary sheets)

Problem under consideration

1. Since 2009, the Financial Services Authority (FSA) and regulators in several jurisdictions have been investigating a number of institutions for alleged manipulation of LIBOR. As of 2 October 2012, the investigation by the FSA into one institution (Barclays) has been completed, which resulted in a record fine of £59.5m, which included a 30% discount for agreeing to settle at an early stage. Barclays were separately fined $360m by the US authorities for activities in relation to LIBOR and EURIBOR. There are a number of other ongoing investigations.

2. In response to these allegations and investigations, the Chancellor of the Exchequer commissioned an independent review of LIBOR by Martin Wheatley, Managing Director of the FSA and CEO-designate of the new Financial Conduct Authority. A conclusion of the Wheatley Review was that self-regulation of LIBOR has failed. In particular, it consisted of insufficient incentives and procedures to ensure that the benchmark was beyond reproach.

Rationale for intervention

3. Recent revelations in relation to LIBOR have shattered confidence in one of the most important benchmarks in the world of finance and tarnished the image of the City. Further, LIBOR is a widely-used benchmark (referenced in at least $300tn worth of contracts globally) and systemically important. Therefore LIBOR reform is a priority issue for the Government and is vital in order to secure continuing market confidence and financial stability, which in turn is good for UK financial services and consumers.

4. Given the allegations and ongoing investigations, and an analysis of the existing LIBOR system, a conclusion of the Wheatley Review was that self-regulation of LIBOR has failed, and therefore that there is a case for government intervention.

Policy Objective

5. LIBOR reform is a priority issue for the Government and is vital in order to secure continuing market confidence and financial stability. The policy objective of the suggested policy proposals is therefore to fully restore credibility in LIBOR as one of the most widely used and systemically important financial benchmarks.

Description of options considered

6. The Wheatley Review considered a number of options in relation to reforming and regulating LIBOR, which are outlined below.

(1) ‘Do nothing’ option

7. The ‘do nothing’ option would leave LIBOR as a self-regulated benchmark that has lost some credibility with markets and the public.

8. The Wheatley Review concluded that the self-regulation model for LIBOR had failed, and that given the large stock of outstanding transactions that reference LIBOR and the lack of viable alternative benchmarks, the wholesale replacement of LIBOR is not feasible.

9. While the status quo is an option, it is unlikely to be a viable alternative if LIBOR is to continue as an important financial benchmark. The 'do nothing' option could be costly in several dimensions. First, contributing banks have made it clear that they are likely to consider leaving the process if LIBOR remains self-regulated, which would create a risk of a disorderly breakdown of this important financial benchmark. Second, the reputations of the financial sector and UK financial services have been damaged, and the 'do nothing' option would not restore it. Further, there are large benefits to the financial markets and the wider public from having credible financial benchmarks, which would not be realised if this option is followed.

(2) Implement the recommendations of the Wheatley Review

10. The recommendations of the Wheatley Review propose that a number of market participants and regulatory bodies take action to strengthen the governance and setting of LIBOR. There are a number of proposals that would result in additional costs to market participants and regulatory authorities, however they would also have the benefit of restoring confidence and credibility to LIBOR, which would have substantial, albeit unquantifiable, benefits – both monetary and non-monetary. These reforms fall into three broad areas: (a) expanding the regulatory perimeter, (b) criminal sanctions for attempted LIBOR manipulation, and (c) a power of compulsion.

Expanding the regulatory perimeter

11. At present neither submitting to, nor administrating LIBOR, is a regulated activity under the Financial Services and Markets Act (FSMA). As a consequence, while the FSA is currently taking regulatory action in relation to attempted manipulation of LIBOR, this is proceeding on the basis of the connection between LIBOR submitting and other regulated activities, and there is no directly applicable, specific regulatory regime covering LIBOR-related activities. This affects the FSA's ability to supervise and take enforcement action in relation to these activities, even when carried out by firms that are regulated in respect of general business activities.

12. Making LIBOR-related activities 'regulated activities' will enhance the ability of the FSA to:

- write and implement rules in relation to the LIBOR process, which will set out the systems and controls that firms must have in relation to LIBOR;
- supervise the conduct of firms and individuals involved in the process, including regular reviews of performance as well as the relevant systems and controls; and,
- take regulatory action for misconduct.

13. It will result in a clear, robust regulatory regime, including the existence of sanctions, which will both act as an incentive for appropriate conduct and enable regulatory authorities to take action in relation to misconduct.

14. Although the scope of regulation is set out in secondary legislation, amendments to both the Financial Services and Markets Act and secondary legislation are needed to enable benchmark-related activities to be brought within regulation.

LIBOR submission as regulated activity

15. On the basis of analysis and consultation responses, the Wheatley Review concluded that, given the risk of misconduct in the contribution of submissions to LIBOR, there is a strong case for making submitting to LIBOR a regulated activity.

LIBOR administration as regulated activity

16. The LIBOR administrator has an integral role in the production of LIBOR. In particular, the administrator is likely to be best-placed to identify any potential manipulation, carry out preliminary enquiries and advise the regulator of any concerns. Failure, therefore, to regulate the administrator could create a gap in the regulatory regime, while such regulation would allow the regulator to ensure that the administrator maintains proper systems and controls for identifying and investigating suspicious behaviour and reporting these to the regulator. The Wheatley Review therefore concluded that LIBOR administration should be a regulated activity.

Criminal sanctions for LIBOR manipulation

17. The Wheatley Review concluded that, in light of the high value of the contracts that reference LIBOR, and the financial benefits that might possibly be obtained from manipulating LIBOR, some individuals may nonetheless be motivated to deliberately and dishonestly attempt to manipulate LIBOR, either directly, or through collusion with others. Such behaviour could be for direct or indirect advantage – for example, the benefiting of certain trading positions – and the perpetrators of such behaviour are likely to be conscious of the dishonesty of their conduct. Civil sanctions under either the existing regulatory code of conduct or civil market abuse regime may therefore be insufficient to deter or prevent such behaviour in all cases.

18. The Review also took the view that the FSA, as the primary financial regulator, should have the powers to investigate and take regulatory action with regard to conduct in financial markets and the financial services sector. Therefore, the Review considered it appropriate that the FSA is able to use its statutory powers of investigation and sanction for misconduct in relation to LIBOR.

19. Further, it could be argued that attempts to manipulate LIBOR constitute sufficiently serious conduct to merit its inclusion as a criminal offence.

EU regulation on Market Abuse (MAR, MIFID, CS-MAD)

20. There already exists a well-developed civil market abuse regime in the UK, which stems largely from the EU Market Abuse Directive 2003. However, the EU and UK market abuse regimes were designed to capture market abuse in relation to financial instruments, and were not constructed with activities such as benchmark manipulation in mind; so are unlikely to capture LIBOR-related misconduct directly. While the Wheatley Review did not recommend any immediate changes to the UK market abuse

regime, it pointed to a number of forthcoming developments in the EU that would have an impact on the UK market abuse regime. Specifically:

- a new Market Abuse Regulation (MAR) is currently being developed, harmonising EU law on market abuse. MAR will apply to all EU countries, and is likely to come into force two years after it is adopted, replacing the existing Market Abuse Directive 2003;
- a new Markets in Financial Instruments Regulation (MiFIR), which for the first time brings benchmarks into the scope of regulation to ensure fair and non-discriminatory access to them and, in doing so, provides an essential underpinning to the market abuse regime; and
- a Directive requiring the establishment of criminal offences for the most serious cases of market abuse (CS-MAD), to which a Justice and Home Affairs "opt-in" applies for the UK and Ireland. The UK may decide to adopt this Directive by opting in to it in due course, providing the standards are sufficiently robust and do not entail a reduction in protections against market abuse. The Government has indicated that it will consider its position once negotiations on MAR and MIFID have concluded.

21. Although no changes to domestic market abuse legislation are suggested at this point, the Government will need to give due consideration to whether and how it incorporates these EU developments into domestic legislation in due course, in order to address concerns around manipulation of benchmarks such as LIBOR.

Power of compulsion

22. At this stage, it is not considered necessary to compel banks to be members of LIBOR panels. However, if submitting banks were to explore leaving panels, compulsion might be necessary in order to prevent a disorderly breakdown of the benchmark and wider financial market disruption and contract frustration. Whilst the FSA currently has the powers to impose such an obligation on a temporary basis on market stability grounds, existing powers would not allow a long term continuing obligation to be imposed. By providing the FSA with an express power to compel LIBOR submissions, the Government can fill a gap in the regulatory toolkit, and address the potential threat to market stability

23. While it is not currently intended to use such a power to increase the number of banks on the LIBOR panels, it could in theory be used in such a way, and this would have corresponding effects on the aggregate cost estimates included here.

24. Therefore, in order to ensure market stability and enhanced input into LIBOR submissions, an express power of compulsion would be created for the FSA to obligation panel banks to submit to LIBOR. This power would only be used by the regulator if absolutely necessary, and consideration will be given to any necessary safeguards to ensure that this does not impose an undue burden on contributing banks.

Monetised and non-monetised costs and benefits of the preferred option (including administrative burden);

Benefits

25. LIBOR is used in contracts worth over $300tn. Implementation of the Wheatley Review recommendations is likely to result in a LIBOR framework that is significantly less vulnerable to attempted manipulation and subject to much stronger governance and regulatory oversight. As a consequence LIBOR will have substantially more credibility and integrity among authorities, market participants and the public, and can therefore continue to serve as an important financial market benchmark.

26. First, contributing banks have made it clear that they are likely to consider leaving the process if LIBOR remains self-regulated, which would create a risk of a disorderly breakdown of this important financial benchmark. Second, the reputations of the financial sector and UK financial services have been damaged, and only comprehensive reform will restore it. Further, there are large benefits to the financial markets and the wider public from having credible financial benchmarks, including: i) reducing the possibility that LIBOR is mis-priced, therefore improving the contracts linked to it and ii) increasing market confidence in the rate; and, iii) preventing a complete dissolution of the rate leading to market disruption.

Costs

27. There are three elements of the Wheatley Review recommendations that are likely to have cost implications: (i) the strengthening of submitting firms' systems and controls; (ii) the strengthening of the oversight by the administrator of the rate; and, (iii) the supervision of LIBOR submission and administration as a regulated activity by the regulator. There will also be some costs associated with (iv) applications in relation to authorisation, variation of permissions and the Approved Persons regime.

28. Cost estimates relate to the additional costs that arise from the new policy regime and regulatory framework, over and above the costs that banks, administrators and regulators currently incur in relation to LIBOR. Given that the precise nature of the new framework is not fully developed and to the extent that estimated costs for contributing banks are intended to represent a typical panel bank, there will be there will be some uncertainty associated with these estimates. In particular, there will be some variation in the sophistication of existing systems and controls across contributing banks and costs may vary depending on the number of LIBOR panels that banks contribute to. Further, the aggregate cost will depend on the total number of banks on LIBOR panels.

29. On the basis that there are currently 23 banks that contribute to LIBOR, it is estimated that the total of these costs will amount to £46.3 million in the first year (a), of which £44.0m will fall on LIBOR panel banks. Thereafter, the additional aggregate running costs for LIBOR submitters are assumed to be £5.8 million annually (b). The number of banks contributing to LIBOR is not static, and may rise or fall, with corresponding effects on the costs of the policy.

30. The annual running costs for the administrator are estimated at £0.3 million (c), and for the regulator around £0.4 million (d).

Table 1: Summary of total aggregate costs
Assumes 23 panel banks, 1 administrator and 1 regulator

	£m		
	Year 1 (transition)		**Ongoing**
Contributing banks[1]	44.0	(38.2)	5.8[(b)]
Administrator[2]	1.9	(1.6)	0.3[(c)]
Regulator[3]	0.4	(0.0)	0.4[(d)]
Total	**46.3[(a)]**	**(39.8)**	**6.5**
Memo: cost to business	*45.9*	*(39.8)*	*6.1*

Notes:
1 See Tables 2 and 5.
2 See Table 3 and 5.
3 See Table 4.
Source: Financial Services Authority estimates

31. The following analysis sets out the key proposals of the report and the potential cost implications. Cost estimates are from the Financial Services Authority, and are based on estimates of IT and staff costs, which in turn are based on a Hudson Banking & Financial Services Salary Guide 2012, Hudson Legal Salary Survey, Russell Reynolds Chairmen and Non-Executive Director Survey 2011, and FSA staff and IT cost estimates. Where costs are employment costs, they are estimated salaries scaled up by 1.3 to account for non-salary employment costs.

(i) Strengthening firms' systems and controls

32. A key recommendation of the Wheatley Review was to require firms submitting LIBOR quotes to ensure they have adequate systems and controls in place to avoid the risk of manipulation of the rate. There will be one-off costs for implementing such stronger controls as well as daily expenses for running them. In terms of the one-off costs, it has been assumed that this might be a larger project undertaken by a team of business experts, compliance staff, lawyers, IT staff and external consultants. Firms would also have to invest in the development of IT systems which can store borrowing and lending transactions (record-keeping), assess daily submissions against underlying data and flag up outliers to business and control staff.

33. Running costs will be affected by increased compliance and internal audit resource. Firms may also have to increase resources in their respective business unit in order to ensure adequate analysis of the underlying data and there might be a greater need for IT support to ensure automatic controls are effective. There will also have to be an increase in senior management time to oversee the effectiveness of the controls in place. Lastly, the Wheatley Review recommended requiring firms to have a six-monthly external audit of their systems and controls.

34. These costs are estimated at £1.91 million per contributing bank for the first year. With 23 banks currently contributing to LIBOR, this would equate to a total cost of £44.0 million.

35. These estimated costs are intended representative of a typical panel bank. With the caveat that each panel bank may have very different systems and controls, the FSA has estimated the incremental costs that strengthening those systems and controls would imply for an average bank. They may vary slightly, depending on the number of LIBOR panels a bank is a member of and the state of their existing systems and controls.

Table 2: Costs to contributing banks

ANNUAL RUNNING COSTS

Area	Category	Annual Salary	Resource requirement	% of year (days)	Total costs
Senior Management	Head of Operations (Investment Bank, Senior)	150,000	Tenth of every trading day; for reviewing Manager's performance/LIBOR process	10% (25)	19,500
LIBOR Manager	Business analyst (Senior)	75,000	Quarter of every trading day; confirmation and sign off of daily submissions	25% (62.5)	24,400
LIBOR Staff	Business analyst (Intermediate)	60,000	Half of every trading day; record keeping, reporting, supporting evidence	50% (125)	39,000
Compliance Officer	Compliance Surveillance (AVP)	55,000	Quarter of every trading day; weekly exception reporting and monitoring	50% (62.5)	17,900
Internal Audit	Compliance Reviews (AVP)	60,000	Quarterly review (1 week) of exception reporting and process	8% (20)	6,200
IT support staff	Service Desk Analyst (Intermediate)	50,000	Support for IT systems; 20 days over one year	8% (20)	5,200
External Audit[1]	External Professional Advisory Charges	691,875	6-monthly review of process (2-weeks), systems and controls; two and a half members of staff	20% (50)	138,400
Executive	Global Head of Compliance	200,000	Hundredth of every trading day; for Review at ExCo level	1% (2.5)	2,600
				Total per bank	**253,200**
				Aggregate	**5,800,000**

SET-UP COSTS

Area	Category	Annual Salary	Resource requirement	% of year (days)	Total costs
Boards[2]	Large firm Board	4,575,000	Review and sign-off	0.4% (1)	23,800
Senior Management	Head of Operations (Investment Bank, Senior)	150,000	Review and sign-off	2% (5)	3,900
LIBOR Manager	Business analyst (Senior)	75,000	2/3rds of time taken up	16% (41.67)	16,300
Libor team member	Business analyst (Intermediate)	60,000	Full-time, 2 staff members	50% (125)	39,000
Internal Consultants	Compliance Surveillance (AVP)	55,000	Full-time, 2 staff members	50% (125)	35,800
External Consultants[1]	External Professional Advisory Charges	691,875	Full-time, 2 and a half staff members	62.5% (156.25)	432,400
Lawyer (internal) [3]	4 years PQE	105,000	Full-time, 1 staff member	25% (62.5)	34,100
IT Staff (team leader)	C++ Team lead (senior)	90,000	Full-time, 1 staff member	25% (62.5)	29,300
IT staff (working level)	C++ Windows Developer - back office (intermediate)	65,000	Full-time, 2 staff members	50% (125)	42,300
Systems[4]		1,000,000	FSA Estimate	N/A	1,000,000
				Total one-off costs per bank	**1,656,900**
				Total Costs per Bank	**1,910,100**
				Aggregate	**43,900,000**

Source: Financial Services Authority (FSA) estimates, based on salary data from Hudson Banking and Financial Services Salary Guide 2012 unless otherwise stated. 1 External Audit costs based on FSA assessment from 2006, uprated with inflation. 2 Russell Reynolds 2011 Chairman & Non-executive Director Survey. 3 Hudson Legal Salary Survey, 2011. 4 FSA estimate, sensed-checked by IT firm IS Data Architecture.

(ii) Administering LIBOR

36. The Wheatley Review recommends that the private organisation administrating LIBOR (including its daily calculation, although this may be outsourced, as is currently the case) takes on much greater responsibility for ensuring the adequacy of submissions and the management of conflicts of interest. The organisation would need to ensure that it has an appropriate level of staff to conduct daily checks of banks' submissions, run an internal escalation procedure and follow-up with the submitters where necessary. It is assumed that this job could be done adequately by a team of five, headed by a manager. It would also require some senior management time for review and escalation of cases of suspicious behaviour.

37. In addition, the organisation would have to set up IT systems to process the information, perform the relevant calculations and interrogate the submissions of panel members. This would result in costs for both the systems and the IT development staff.

38. It is estimated that the organisation administrating LIBOR would incur additional costs as a consequence of the new regulations of £1.78 million over the first year. It is possible that it will be able to recover some of these costs from user charges or similar, although this is difficult to estimate, and may depend on the design of the tender process for a new administrator.

39. These estimates is based on the assumption that the new regulatory environment will require a significant strengthening of processes, however the actual costs will vary depending on the model implemented by the new administrator. The administrator will be chosen by a tender process, and the criteria will be based heavily around the new systems that prospective bidders intend to implement in order to ensure the credibility of LIBOR in the future.

Table 3: Costs to LIBOR administrator

ANNUAL RUNNING COSTS

Area	Category	Annual Salary	Resource requirement	% of year (days)	Total costs
Senior Management	Business analyst (Senior)	70,000	Tenth of every trading day; for reviewing LIBOR process and team performance; escalation of key	10% (25)	9,100
Manager	Business analyst (Intermediate)	60,000	Full-time; direct oversight of daily process, review of exemptions reporting	100% (250)	78,000
Associates	Business analyst (junior)	45,000	Full-time; four associates collating submissions, running calculations and performing manual and automated controls	4x100% (1000)	234,000
IT support staff	Service Desk Analyst (Intermediate)	50,000	Support for IT systems; 20 days over one year	8% (20)	5,200
				Total running cost	**326,300**

SET-UP COSTS (3-MONTHS)

Area	Category	Annual Salary/Cost	Resource requirement	% of year (days)	Total costs
IT Staff (team leader)	C++ Team lead (senior)	90,000	Full-time, 1 staff member	25% (62.5)	29,250
IT staff (working level)	C++ Windows Developer - back office (intermediate)	65,000	Full-time, 2 staff members	50% (125)	42,250
Systems[1]		1,500,000	Estimate of hard and software costs	N/A	1,500,000
				Total set-up cost	1,571,500
				Total cost	**1,897,800**

Source: Financial Services Authority estimates, based on salary data from Hudson Banking and Financial Services Salary Guide 2012 unless otherwise stated. 1 FSA estimate, sensed-checked by IT firm IS Data Architecture

(iii) Supervising LIBOR

40. The Wheatley review recommends that the administration and submission to LIBOR is made a regulated activity and for the FSA to supervise the conduct of the firms and individuals involved in the process of setting the rate. The FSA is likely to require additional specialised supervisory resource. It is also assumed that once the setting of LIBOR becomes a regulated activity, the FSA will need to conduct a thematic review of the systems and controls in place at panel banks to assert compliance with the rules and regulations associated with this regulated activity.

41. It is assumed that the additional specialised resource would be a team of five, with a manager leading it. This would comprise the monitoring of submissions, regular reviews of systems and controls at firms and the supervision of the administrator. The thematic review of systems and controls would be conducted by a team of five and would probably take about 3 months.

42. These assumptions lead us to assume that the costs of supervising LIBOR submissions would be £0.4m per year.

Table 4: Costs to regulator in relation to LIBOR

Item	Resource required	% of year (days)	Annual employment cost	Estimated cost (days/250* annual cost)
Annual Costs				
Head of Department	10th of every trading day; review and approval	10% (25)	195,000	19,500
Manager	Quarter of every trading day; 1 member of staff	25% (62.5)	118,950	29,700
Senior Associate	Full-time, 2 members of staff	2x100%(500)	81,900	163,800
Associate	Full time; 2 members of staff	2x100%(500)	55,250	110,500
3–month Thematic Review				
Technical Specialist	Quarter of every trading day; 1 member of staff	6.25% (15.5)	118,950	7,400
Senior Associate	Full-time; two members of staff	2x25% (125)	81,900	41,000
Associate	Full-time; two members of staff	2x25% (125)	55,250	27,600
			Total Cost	**399,500**

Source: Financial Services Authority estimates based on FSA employment costs.

(iv) Authorisations and Approved Persons

43. The Wheatley Review's recommendation to make the submission to and the administration of LIBOR a regulated activity means that firms need to be authorised to carry out these activities. For current panel banks the approach might be to deem them authorised and thus they would simply require a variation of permission. However, the administrator of the rate will need to apply for authorisation.

44. The Review also recommends creating an approved persons regime. The manager of the team responsible for submission to LIBOR panels within a bank will need to apply for approval from the FSA. Similarly, the individual carrying out the respective role within the rate administrator would have to be approved by the FSA.

45. Based on a review conducted by Real Assurance Risk Management in 2006 and adjusting for inflation, it is estimated that a variation of permission would cost £2,700, while a full-scale application of authorisation for the administration of LIBOR would attract costs of £12,300. Assuming that all individuals applying for approved person status needed to be interviewed, the cost to a firm for this process would amount to £2,500.

46. Assuming 23 panel banks, the total cost to firms submitting to and administrating LIBOR of obtaining the right authorisations and having the relevant individuals approved by the FSA would amount to £140,000. This represents the cost estimated for the first year and should be substantially lower in subsequent years. These are included in the first column of Table 1, with £12,300 attributed to the administrator, and £126,500 attributed to contributing banks.

Table 5: Costs associated with Authorisation and Approved Persons

Organisation	Cost Item	Cost to organisation	Aggregate Cost
Contributing Bank	Approved Persons application - application	250	5,750
	Approved Persons application - interview preparation	2,500	57,500
	Variation of permission	2,750	63,250
	Cost to banks		**126,500**
Administrator	Application for authorisation	12,300	12,300
	Cost to administrator		**12,300**

Source: FSA estimates. Assumes 23 contributing banks.

One In, One Out (OIOO)

47. The policy is out of scope of 'One In, One Out', because it deals with systemic financial risk. Libor is a systemically important benchmark that is used in contracts with a total value of at least $300tn globally.

Equalities

48. The Government has considered its obligations under the Equalities Act 2010. We do not believe these measures will impact upon discrimination, equality of opportunity or good relations towards people who share relevant protected characteristics under that act. The detrimental effects of a loss in confidence and credibility in LIBOR would affect a broad-base of market participants and, indirectly, the public. Implementing these reforms to LIBOR will have similarly broad and non-discriminatory benefits.

Wider impacts

49. The policy is not expected to have any wider impacts, although it is impossible to rule them out completely as it may depend on actions beyond the control of the review. In particular, all reasonable steps have to be taken to ensure that policy has no systemic effect on the LIBOR rate, or other similar effects.

Proposed Implementation

Early November: Amendments to the Financial Services Bill to include amendments to the Financial Services and Markets Act (FSMA) at Report Stage. Begin consultation on amendments to associated secondary legislation.

By January 2013: Amendments to secondary legislation laid before parliament.

By April 2013: Changes to primary and secondary legislation to be implemented.

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This document can be found in full on our website: http://www.hm-treasury.gov.uk

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