

FINANCIAL SERVICES AND MARKETS ACT 2000

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part XVIII: Recognised Investment Exchanges and Clearing Houses

514. This Part provides for the regulatory regime for recognised investment exchanges and clearing houses. These recognised bodies are exempt from the need to be authorised. This regime is similar to that under the FS Act 1986.
515. Chapter I of this Part:
- gives the Treasury the power to set the requirements that such bodies have to meet in order to be recognised;
 - sets out the application procedures and supervisory arrangements for recognised bodies, including conferring powers to revoke recognition and to direct recognised bodies to take steps to meet the recognition requirements;
 - allows the Treasury, jointly with the Secretary of State, to extend special protection from insolvency law to organisations clearing certain non-investment contracts.
516. Chapter II provides for competition scrutiny of recognised bodies. This places a duty on the DGFT, and gives him powers, to investigate and report to the Competition Commission on any significantly adverse effects on competition of these bodies' rules, guidance and practices, or any exploitation of a strong market position. It allows the Treasury, on receipt of a further report from the Commission, to direct, through the Authority, that appropriate changes are made to such rules, guidance or practices. Chapter III disapplies the general domestic competition law as it affects the matters covered by the Act regime. Chapter IV contains definitions of key terms.

Chapter I: Exemption

Section 285: Exemption for recognised investment exchanges and clearing houses

517. *Subsection (1)* defines what is meant by a recognised investment exchange and clearing house.
518. *Subsections (2) and (3)* set out the scope of the exemption for recognised bodies from the need to be authorised in order to carry on regulated activities which it carries on as an exchange or clearing house. Exchanges are also exempt as respects anything they do for the purposes of, or in connection with, the provision of clearing services.

Section 286: Qualification for recognition

519. *Subsection (1)* allows the Treasury to set recognition requirements by regulations. Recognition requirements are the requirements which must be satisfied

by an exchange or clearing house in order both to become recognised, and to remain recognised.

520. *Subsection (2)* provides that if the regulations made under *subsection (1)* contain provisions relating to the default rules of a recognised body, then the Treasury has to have the approval of the Secretary of State before making the regulations. (The Secretary of State is responsible for insolvency matters.)
521. *Subsection (3)* defines default rules. These are rules which provide for action to be taken to settle market contracts in the event of a default; for example, the rules may specify the means for establishing the price at which a bargain should be made. These are necessary to protect against systemic risk in the financial markets. If contracts could not be closed out in an orderly and speedy manner, a default by one market participant could spread quickly to large numbers of market participants.
522. *Subsection (4)* defines market contract by reference to Part VII of the Companies Act 1989 (or the corresponding Order in Northern Ireland). Market contracts in this context are those entered into by the exchange or clearing house or by the members of an exchange.

Section 287: Application by an investment exchange

523. This section allows an organisation to apply for recognition as a recognised investment exchange and sets out the information that the applicant must send to the Authority.

Section 288: Application by a clearing house

524. This section allows an organisation to apply for recognition as a clearing house and sets out the information that the applicant must send to the Authority.

Section 289: Applications: supplementary

525 This section allows the Authority to seek additional information, in whatever form it requires, in respect of any application for recognition under sections 287 and 288. It also allows the Authority to require verification of that information.

Section 290: Recognition orders

526. This section allows the Authority to make a recognition order if it is satisfied that the applicant meets the recognition requirements. The Authority is not obliged to make a recognition order in this circumstance and *subsection (3)* allows the Authority to take any information into account, and not just information concerning the recognition requirements, when deciding whether to grant recognition.
527. *Subsection (2)* requires the Treasury to give their approval under section 307 before the making of a recognition order. The role of the Treasury under that section concerns cases where there is an issue as to whether the rules and other regulatory provisions of the exchange or clearing house have a significantly adverse, and unjustified, effect on competition.

Section 291: Liability in relation to recognised body's regulatory functions

528. This section gives recognised investment exchanges immunity against legal action for damages in respect of anything done or omitted in the discharge of the recognised body's regulatory functions. This immunity does not apply where the act or omission was in bad faith or where it was unlawful as a result of section 6(1) of the Human Rights Act 1998. Under section 6(1) of that Act, it is unlawful for a public authority to act in a way which is incompatible with a right conferred by the European Convention on Human Rights and Fundamental Freedoms which is included in Schedule 1 to the 1998 Act.

Section 292: Overseas investment exchanges and overseas clearing houses

529. This section modifies the application procedures and requirements where the applicant concerned is an overseas investment exchange or clearing house.
530. In order to be recognised, an overseas applicant need not comply with the recognition requirements made by the Treasury under section 286. Instead, *subsection (2)* provides that the Authority may make a recognition order in respect of an overseas applicant if the requirements set out in *subsection (3)* are met. These requirements are that investors are afforded protection equivalent to that which they would have had if the overseas body were required to comply with the recognition requirements; that there are adequate default procedures; that the applicant is able and willing to co-operate with the Authority; and that adequate arrangements are in place enabling the Authority to cooperate, for example through the sharing of information, with the overseas body's home State supervisor.
531. *Subsection (5)* makes some changes as to how other provisions of this Part work in respect of overseas bodies given that the relevant requirements which they have to meet are those set out in *subsection (3)* rather than the recognition requirements made by the Treasury.

Section 293: Notification requirements

532. *Subsections (1) to (4)* allow the Authority to make rules requiring a recognised body to give it notice of, and information about, specified events or information about the recognised body which the Authority reasonably requires to carry out its functions. The Authority can also specify when, and in what form, the information should be provided.
533. *Subsections (5) to (7)* place a duty on the recognised body to give the Authority immediate notice of new rules and guidance, or of changes to existing rules and guidance. Recognised bodies are also required to notify the Authority of changes to their clearing arrangements. *Subsection (8)* provides that these duties do not apply to recognised overseas bodies. They are placed under different obligations under section 295.

Section 294: Modification or waiver of rules

534. This section gives the Authority power to waive or modify the notification rules it can make under sections 293 and 295, at the request of the recognised body or with their consent. *Subsection (4)* sets out the circumstances in which the Authority may do this.

Section 295: Notification: overseas investment exchanges and overseas clearing houses

535. This section requires overseas investment exchanges and clearing houses to produce a report at least once a year giving details of any events which have occurred over the year which may have an effect on competition, or which might affect the Authority's assessment of whether the requirements set out in section 292 are satisfied. The Authority can also make rules requiring that additional information should be included in the report.

Section 296: Authority's power to give directions

536. This section allows the Authority to direct a recognised body which has failed to satisfy the recognition criteria, or has failed to comply with other obligations under the Act (for example those in this Part) to take steps to remedy that failure. This power enables the Authority to deal with problems which are not sufficiently serious to merit withdrawal of recognition from the body concerned.

Section 297: Revoking recognition

537. This section allows the Authority to revoke the recognition of a body which no longer wishes to remain recognised, or which no longer meets the recognition criteria or which has failed to comply with other obligations under the Act.

Section 298: Directions and revocation: procedure

538. This section sets out the procedure the Authority must follow when it proposes to give a direction or make a revocation order. This includes giving the recognised body, its members and third parties who might be affected the right to make written representations. *Subsection (7)* allows the Authority to give a direction without following these procedures if it considers that it is essential to do so.

Section 299: Complaints about recognised bodies

539. This section provides that the Authority must establish a procedure for the investigation of complaints against recognised bodies where the complaint is relevant to the question of whether the body should remain recognised or not.

Section 300: Extension of functions of Tribunal

540. This section gives the Treasury a power to extend, by order, the jurisdiction of the Financial Services and Markets Tribunal to certain disciplinary proceedings brought by a recognised UK exchange or clearing house. An order may be made in respect of one or more specified recognised exchanges or clearing houses or in respect of recognised exchanges or clearing houses generally.
541. *Subsections (1) and (4)* make clear that jurisdiction may only be extended to cases involving internal disciplinary proceedings taken against members of recognised investment exchanges or recognised clearing houses for breaches of the rules of the exchange or clearing house in cases of behaviour which amounts to market abuse. Since it may be necessary to modify the provisions of the Act relating to proceedings before the Tribunal to accommodate the particular circumstances of a recognised exchange or clearing house, *subsection (3)* enables the Treasury to make any modifications that are necessary.
542. *Subsection (2)* deals with the circumstances in which jurisdiction may be extended. *Subsection (2)(a)* enables jurisdiction to be extended where the Treasury are satisfied that it is necessary to do so in order to ensure consistency between decisions taken in exchange or clearing house disciplinary proceedings involving market abuse and Tribunal decisions in such cases (including Tribunal decisions relating to the relevant disciplinary proceedings of other recognised exchanges or clearing houses). *Subsection (2)(b)* would enable the Treasury to extend the role of the Tribunal to recognised exchange or clearing house disciplinary proceedings in cases of market abuse if it should prove necessary to do so in the future in the light of the developing jurisprudence of the European Court of Human Rights.

Section 301: Supervision of certain contracts

543. This section allows the Treasury, acting jointly with the Secretary of State, to make regulations which extend the provisions of Part VII of the Companies Act 1989 (or the equivalent provision of the Northern Ireland Order), with any appropriate modifications, to certain non-investment contracts. Part VII of the Companies Act 1989 disapplies various provisions of insolvency law for market contracts in order to protect against systemic risk in the financial markets.
544. *Subsection (2) and (3)* set out what kind of contracts can be covered by these regulations. There are two criteria:

- first, the contracts must be settled by someone who is on a list maintained by the Authority for the purposes of this section. The Treasury, under *subsection (4)*, has to approve the conditions set by the Authority for admission to this list and the arrangements for admission to and removal from the list;
 - second, the Treasury and the Secretary of State have to be satisfied that it is appropriate for the Authority to supervise the settlement arrangements for these non-investment contracts. In coming to a view, the Treasury and Secretary of State must have regard to the extent to which the contracts are dealt in by persons supervised by the Authority.
545. *Subsection (10)* allows the Treasury and the Secretary of State, in making regulations under this section, to apply any of the provisions of this Act to the person settling these contracts. Without this power it would not be possible for the Authority to regulate such persons on a statutory basis, since they would be clearing non-investment contracts and so would not require authorisation or exemption.

Chapter II: Competition Scrutiny

Section 302: Interpretation

546. This section describes the “regulatory provisions” (that is the rules, guidance, arrangements and particulars) and “practices” which are to be scrutinised under this Part to assess whether they have, or are intended or likely to have, a significantly adverse effect on competition as defined in this section.

Section 303: Initial report by Director

547. This section requires the Authority to send to the DGFT and to the Treasury all the regulatory provisions and any other relevant information received in support of an application for recognition. The DGFT must then issue a report as to whether any of these provisions has a significantly adverse effect on competition.

Section 304: Further reports by Director

548. This section requires the DGFT to keep all recognised investment exchanges and clearing houses under continuing competition scrutiny. If, at any time, the DGFT forms the view that any regulatory provision or practice has a significantly adverse effect on competition then he must make a report.
549. *Subsection (3)* provides that if the DGFT concludes that regulatory provisions or practices do not have such an effect then he has discretion as to whether to make a report.

Section 305: Investigations by Director

550. This section confers powers on the DGFT to enable him to carry out his functions under sections 303 and 304. The DGFT will be able to request relevant documents from any person, and to request relevant information from any business.
551. *Subsections (5) and (6)* provide that if a person fails to produce the information or documents required, then the DGFT may report the matter to the court. If the court is satisfied that there was no reasonable excuse for this failure, the person may be dealt with as if he were in contempt of court.

Section 306: Consideration by Competition Commission

552. This section concerns the role and duties of the Commission following receipt of a report from the Director General. Its functions and duties are in line with those set out in the analogous provisions in section 162 in Part X. This section is supplemented by the provisions of Schedule 14. (This Schedule also applies to section 162, which

relates to the Commission's role in competition scrutiny of the regulating provisions and practices of the Authority.)

Section 307: Recognition orders: role of the Treasury

553. This section sets out the Treasury's powers to take action following an adverse report from the Commission on an application for a recognition order.
554. If the Commission's report concludes that no significantly adverse effect on competition exists, or such an effect does exist, but is justified, *subsection (2)* requires that the Treasury must approve the making of the recognition order unless exceptional circumstances exist to justify their refusal. If, however, the Commission's report is that a significantly adverse effect on competition exists, and is not justified, then *subsection (4)* requires that the Treasury, unless exceptional circumstances exist, should refuse to approve the making of the recognition order.

Section 308: Directions by the Treasury

555. This section concerns the Treasury's powers to take action following an adverse report from the Commission, other than a report on an application for a recognition order.
556. If the Commission's report is that the anti-competitive effect is not justified, *subsection (2)* requires that the Treasury give a "remedial direction". (A remedial direction is defined in *subsection (8)* as a direction to the Authority to either revoke the recognition of the body concerned, or to direct the body to take specified steps as set out in the direction.) However, *subsection (3)* provides that the Treasury need not give a direction either where the Treasury consider that it is not necessary as a result of action which has already been taken by the body concerned or by the Authority, or because exceptional circumstances exist which makes it inappropriate or unnecessary to give a direction. Conversely, if the Commission's conclusion is that the anti-competitive effect is justified, under *subsections (5) and (6)* the Treasury may nonetheless give a direction to the Authority to take action which the Treasury consider necessary because of exceptional circumstances of the case.

Section 309: Statements by the Treasury

557. This section makes provision for statements to be made by the Treasury when they decline to give a remedial direction under the preceding section.
558. *Subsection (1)* provides that if the Treasury decide not to give a remedial direction action following a Commission report that they should, they must produce a statement giving their reasons. *Subsection (2)* provides that if they do give such direction they must give details of this. In addition, if they have made a direction in a case where the Commission has concluded that the adverse effect on competition is justified, they must publish a statement giving their reasons for doing so.

Chapter III: Exclusion from the Competition Act 1998

Section 311: The Chapter I prohibition

559. This section makes clear that the prohibition of agreements preventing, restricting or distorting competition within the United Kingdom in Chapter I of the Competition Act 1998 does not apply to the constitution of a recognised investment exchange or clearing house or to a body which has applied for recognition; nor to the regulatory provisions of a recognised body; nor to a decision or practice of a recognised body, in respect of its regulatory functions; nor to an agreement the parties to which include a recognised body or person subject to its rules to the extent that the agreement is required or encouraged by the recognised body's regulatory provisions or practices.

Section 312: The Chapter II prohibition

560. This section makes clear that the prohibition of abuse of a dominant position in a market which may affect trade in the United Kingdom in Chapter II of the Competition Act 1998, does not apply to the regulatory provisions or practices of a recognised investment exchange or clearing house, nor to agreements entered into by its members, to the extent that these are required by the body's regulatory provisions.