

**EXPLANATORY MEMORANDUM TO**  
**THE FINANCIAL MARKETS AND INSOLVENCY (SETTLEMENT FINALITY**  
**AND FINANCIAL COLLATERAL ARRANGEMENTS) (AMENDMENT)**  
**REGULATIONS 2010**

**2010 No. 2993**

1. This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. **Purpose of the instrument**

2.1 Is to make amendments to the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (“the 1999 Regulations”) and the Financial Collateral Arrangements (No 2) Regulations 2003 (“the 2003 Regulations”) to implement Directive 2009/44/EC of the European Parliament and of the Council amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims (OJ L 146. 10.6.2009, p37) (“the 2009 Directive”), and to give further implementation to Directives 98/26/EC and 2002/47/EC.

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

3.1 None.

4. **Legislative Context**

4.1 Directive 98/26/EC of the European Parliament and of the Council on settlement finality in payment and securities systems (OJ L166, 19.5.98 p.45) seeks to minimise the disruption caused by insolvency proceedings brought against a participant in payment and securities systems. It was implemented by the 1999 Regulations, which protect any system which has been designated by the Bank of England or the Financial Services Authority. Directive 2002/47/EC seeks to create a uniform EU legal framework to limit credit risk in financial transactions through the provision of securities and cash as collateral. It was implemented by the 2003 Regulations, which disapply legislation requiring formalities and provisions of insolvency law in relation to financial collateral arrangements.

4.2 The amendments made by the 2009 Directive make further provision for linked or “interoperable” systems, and ensure that credit claims may be used as a form of collateral. These Regulations amend the 1999 Regulations and the 2003 Regulations to implement the 2009 Directive, to make further disapplications of insolvency law in the 2003 Regulations, and to ensure that Directives 98/26/EC and 2002/47/EC are effectively implemented in Scottish law.

4.3 A transposition note setting out how the provisions of the 2009 Directive are being implemented into UK law is attached at Annex A.

## **5. Territorial Extent and Application**

5.1 This instrument applies to the United Kingdom.

## **6. European Convention on Human Rights**

6.1 As the instrument is subject to the negative resolution procedure and does not amend primary legislation, a compatibility statement is not required.

## **7. Policy background**

- *What is being done and why*

7.1 On 6 May 2009 the European Parliament and Council adopted Directive 2009/44/EC (known as the Amending Directive) which amends previous European Directives 98/26/EC and 2002/47/EC on settlement finality in payment and securities settlement systems (SFD) and financial collateral arrangements (FCD). This was done after the European Commission had looked at the directives to see if they were working, and concluded that some improvements and clarification were needed to be made, because of the changing post trade environment. They decided to amend the two directives together in one directive as they are closely connected.

7.2 Reflecting the increasing number of linkages between payment and securities settlement systems, the key changes to the SFD are to define “interoperable systems” and to clarify the responsibility of system operators. The definition of “indirect participant” is also amended to include linked systems. The amending SI reproduces the definition in the Amending Directive of “interoperable systems” and further introduces the term into the relevant parts of the 1999 Regulations to ensure that the insolvency-related provisions which apply to systems also apply to interoperable systems.

7.3 The key change to the FCD is to extend the definition of “financial collateral” from cash and financial instruments to include credit claims (i.e. loans, broadly speaking). This ensures that where credit claims are used as financial collateral, the collateral taker gains certain protections against the insolvency of the collateral provider. This will increase the pool of available collateral. The amending S.I. extends the protections given in the 2003 Regulations to such collateral, and disapplies additional provisions of insolvency law to ensure that financial collateral is fully protected.

7.4 Member states have a European deadline of 30 December 2010 to adopt and publish their implementing regulations which have to apply from 30 June 2011.

## **Consolidation**

7.5 The Treasury does not have plans to consolidate the 1999 regulations with amendments at this time. Commercial publishers produce consolidated versions of the 1999 Regulations, both in electronic and hard copy versions.

## **8. Consultation outcome**

8.1 HM Treasury ran a consultation process on the proposed draft UK implementation regulations between August and October 2010. HM Treasury received sixteen responses, ranging from law firms, members of the public, trade associations, a clearing and settlement firm and banks.

8.2 The majority of the respondents supported the draft SI. In particular Article 2 (4)d of the amending directive which gives Member states the option (other than where the collateral giver or taker is a central bank of excluding credit claims from the FCD regime where the debtor covered by the credit claim is a consumer or a small or micro business. We do not propose to exercise this option and this was supported by all the respondents to this consultation question.

8.3 Many respondents requested that additional amendments should be made to these Regulations. In a number of cases (as set out in more detail in the summary of responses) where the suggested amendments improved the implementation of the amending directive, we have incorporated them in the Regulations.

## **9. Guidance**

9.1 The Treasury does not propose to produce any guidance in relation to the Regulations.

## **10. Impact**

10.1 The legislation does not have any impact on business, charities or voluntary bodies.

10.2 The legislation does not have any impact on the public sector.

10.3 An Impact Assessment is attached to this memorandum.

## **11. Regulating small business**

11.1 The legislation does not apply to small business.

## **12. Monitoring & review**

12.1 There are no formal plans for the legislation to be reviewed at set intervals. However, the legislation is likely to be reviewed at appropriate intervals to ensure that it reflects the current insolvency law.

### **13. Contact**

Helena Forrest at HM Treasury Tel: 020 7270 569 or email: [Helena.Forrest@hmtreasury.gsi.gov.uk](mailto:Helena.Forrest@hmtreasury.gsi.gov.uk) can answer any queries regarding the instrument.

## ANNEX A

### IMPLEMENTING DIRECTIVE 2009/44/ - A TRANSPOSITION NOTE

**Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims**

#### Abbreviations:

“1999 Regulations” means the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (S.I. 1999/2979)

“2003 Regulations” means the Financial Collateral Arrangements (No 2) Regulations 2003 (S.I. 2003/3226)

“Amending Regulations” means the “Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010

Article / paragraph	Full text of the provision	Relevant domestic provision	Responsibility
Article 1(4)(a)	(4) Article 1 shall be amended as follows: (a) in point (a), the word "ecu" shall be replaced by the word "euro";	1999 Regulations, regulation 2(3)	The Treasury
Article 1(4)(b)	(b) in point (c), the second indent shall be replaced by the following: "— operations of the central banks of the Member States or the European Central Bank in the context of their function as central banks."	1999 Regulations, regulation 2(1), definition of “collateral security” and “central bank”	The Treasury
Article 1(5)  Article 1(5)(a)(i)	(5) Article 2 shall be amended as follows: (a) point (a) shall be amended as follows: (i) the first indent shall be replaced by the following: "— between three or more participants, excluding the system operator of that system, a possible settlement agent, a possible central counterparty, a possible clearing house or a possible indirect participant, with common rules and standardised arrangements for the clearing, whether or not through a central counterparty, or execution of transfer orders between the participants,";	1999 Regulations, regulation 2(3)	The Treasury
Article 1(5)(a)(ii)	(ii) the following subparagraph is added: "An arrangement entered into between interoperable systems shall not constitute a system.";	1999 Regulations, paragraph 1(5) of the Schedule to the Regulations, as amended by regulation 2(17)(a) of Amending Regulations	The Treasury

Article / paragraph	Full text of the provision	Relevant domestic provision	Responsibility
Article 1(5)(b)	(b) in point (b), the first and second indents are replaced by the following: "— a credit institution as defined in Article 4(1) of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) [] including the institutions listed in Article 2 of that Directive,	1999 Regulations, regulation 2(1) definition of "credit institution", amended by regulation 2(2)(e) of the Amending Regulations. See also the definition of "institution" amended by regulation 2(2)(h)(i) of the Amending Regulations.	The Treasury
	— an investment firm as defined in Article 4(1)(1) of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments [], excluding the institutions set out in Article 2(1) thereof,	1999 Regulations, regulation 2(3)	The Treasury
Article 1(5)(c) Article 1(5)(c)(i)	(c) point (f) shall be amended as follows: (i) the first subparagraph shall be replaced by the following: "(f) "participant" shall mean an institution, a central counterparty, a settlement agent, a clearing house or a system operator.";	1999 Regulations, regulation 2(1), definition of "participant", as amended by regulation 2(2)(i) of the Amending Regulations	The Treasury
Article 1(5)(c)(ii)	(ii) the third subparagraph shall be replaced by the following: "A Member State may decide that, for the purposes of this Directive, an indirect participant may be considered a participant if that is justified on the grounds of systemic risk. Where an indirect participant is considered to be a participant on grounds of systemic risk, this does not limit the responsibility of the participant through which the indirect participant passes transfer orders to the system.";	1999 Regulations, regulation 9, as amended by regulation 2(8) of the Amending Regulations	The Treasury
Article 1(5)(d)	(d) point (g) shall be replaced by the following: "(g) "indirect participant" shall mean an institution, a central counterparty, a settlement agent, a clearing house or a system operator with a contractual relationship with a participant in a system executing transfer orders which enables the indirect participant to pass transfer orders through the system, provided that the indirect participant is known to the system operator.";	1999 Regulations, regulation 2(1), definition of "indirect participant", as amended by regulation 2(2)(g) of the Amending Regulations	The Treasury
Article 1(5)(e)	(e) point (h) shall be replaced by the following: "(h) "securities" shall mean all instruments referred to in section C of Annex I to Directive 2004/39/EC;"	1999 Regulations, regulation 2(1), definition of "securities", as amended by the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2007 (SI 2007/126), Schedule 6, paragraph 14.	The Treasury

Article / paragraph	Full text of the provision	Relevant domestic provision	Responsibility
Article 1(5)(f)	(f) in point (i), the first indent shall be replaced by the following:  "— any instruction by a participant to place at the disposal of a recipient an amount of money by means of a book entry on the accounts of a credit institution, a central bank, a central counterparty or a settlement agent, or any instruction which results in the assumption or discharge of a payment obligation as defined by the rules of the system, or";	1999 Regulations, regulation 2(1), definition of "transfer order", as amended by regulation 2(2)(n) of the Amending Regulations	The Treasury
Article 1(5)(g)	(g) point (l) shall be replaced by the following:  "(l) "settlement account" shall mean an account at a central bank, a settlement agent or a central counterparty used to hold funds or securities and to settle transactions between participants in a system;";	1999 Regulations, regulation 2(1), definition of "settlement account", as amended by regulation 2(2)(k) of the Amending Regulations	The Treasury
Article 1(5)(h)	(h) point (m) shall be replaced by the following:  "(m) "collateral security" shall mean all realisable assets, including, without limitations, financial collateral referred to in Article 1(4)(a) of Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements [], provided under a pledge (including money provided under a pledge), a repurchase or similar agreement, or otherwise, for the purpose of securing rights and obligations potentially arising in connection with a system, or provided to central banks of the Member States or to the European Central Bank;	1999 Regulations, regulation 2(1), definition of "collateral security", and as amended by regulation 2(2)(d) of the Amending Regulations,	The Treasury
Article 1(5)(i)	(i) the following points shall be added:  "(n) "business day" shall cover both day and night-time settlements and shall encompass all events happening during the business cycle of a system;  (o) "interoperable systems" shall mean two or more systems whose system operators have entered into an arrangement with one another that involves cross-system execution of transfer orders;  (p) "system operator" shall mean the entity or entities legally responsible for the operation of a system. A system operator may also act as a settlement agent, central counterparty or clearing house."	1999 Regulations, regulation 2(1), definitions of "business day", "interoperable systems", "system operator", as inserted by regulation 2(2)(a) of the Amending Regulations	The Treasury

Article / paragraph	Full text of the provision	Relevant domestic provision	Responsibility
Article 1(6) Article 1(6)(a)	(6) Article 3 shall be amended as follows: (a) paragraph 1 shall be replaced by the following: "1. Transfer orders and netting shall be legally enforceable and binding on third parties even in the event of insolvency proceedings against a participant, provided that transfer orders were entered into the system before the moment of opening of such insolvency proceedings as defined in Article 6(1). This shall apply even in the event of insolvency proceedings against a participant (in the system concerned or in an interoperable system) or against the system operator of an interoperable system which is not a participant.	1999 Regulations, regulations 13, 14, 15, 16, 20(1), as amended by regulation 2(10), (11), (12) and 2(13)(a),(b) of the Amending Regulations	The Treasury
	Where transfer orders are entered into a system after the moment of opening of insolvency proceedings and are carried out within the business day, as defined by the rules of the system, during which the opening of such proceedings occur, they shall be legally enforceable and binding on third parties only if the system operator can prove that, at the time that such transfer orders become irrevocable, it was neither aware, nor should have been aware, of the opening of such proceedings.";	1999 Regulations, regulation 20(2) as amended by regulation 2(2)(13)(c)	The Treasury
Article 1(6)(b)	(b) the following paragraph is added: "4. In the case of interoperable systems, each system determines in its own rules the moment of entry into its system, in such a way as to ensure, to the extent possible, that the rules of all interoperable systems concerned are coordinated in this regard. Unless expressly provided for by the rules of all the systems that are party to the interoperable systems, one system's rules on the moment of entry shall not be affected by any rules of the other systems with which it is interoperable."	1999 Regulations, paragraph 5 of the Schedule to the Regulations, as amended by regulation 2(17)(d) of the Amending Regulations	The Treasury
Article 1(7)	(7) Article 4 shall be replaced by the following: "Article 4 Member States may provide that the opening of insolvency proceedings against a participant or a system operator of an interoperable system shall not prevent funds or securities available on the settlement account of that participant from being used to fulfil that participant's obligations in the system or in an interoperable system on the business day of the opening of the insolvency proceedings. Member States may also provide that such a participant's credit facility connected to the system be used against available, existing collateral security to fulfil that participant's obligations in the system or in an interoperable system."	The UK has not exercised this option	



Article / paragraph	Full text of the provision	Relevant domestic provision	Responsibility
Article 1(8)	<p>(8) In Article 5, the following paragraph shall be added:</p> <p>"In the case of interoperable systems, each system determines in its own rules the moment of irrevocability, in such a way as to ensure, to the extent possible, that the rules of all interoperable systems concerned are coordinated in this regard. Unless expressly provided for by the rules of all the systems that are party to the interoperable systems, one system's rules on the moment of irrevocability shall not be affected by any rules of the other systems with which it is interoperable."</p>	1999 Regulations, paragraph 5 of the Schedule to the Regulations, as amended by regulation 2(17)(d) of the Amending Regulations	The Treasury
Article 1(9)	<p>(9) Article 7 shall be replaced by the following:</p> <p>"Article 7</p> <p>Insolvency proceedings shall not have retroactive effects on the rights and obligations of a participant arising from, or in connection with, its participation in a system before the moment of opening of such proceedings as defined in Article 6(1). This shall apply, inter alia, as regards the rights and obligations of a participant in an interoperable system, or of a system operator of an interoperable system which is not a participant."</p>	1999 Regulations, regulations 13(2), as amended by regulation 2(10) of the Amending Regulations	The Treasury
Article 1(10)	<p>(10) Article 9 shall be replaced by the following:</p> <p>"Article 9</p> <p>1. The rights of a system operator or of a participant to collateral security provided to them in connection with a system or any interoperable system, and the rights of central banks of the Member States or the European Central Bank to collateral security provided to them, shall not be affected by insolvency proceedings against:</p> <p>(a) the participant (in the system concerned or in an interoperable system);</p> <p>(b) the system operator of an interoperable system which is not a participant;</p> <p>(c) a counterparty to central banks of the Member States or the European Central Bank; or</p> <p>(d) any third party which provided the collateral security.</p> <p>Such collateral security may be realised for the satisfaction of those rights.</p>	1999 Regulations, regulations 18 and 19, with regulation 13(2) as amended by regulation 2(10) of the Amending Regulations	The Treasury
	<p>2. Where securities including rights in securities are provided as collateral security to participants, system operators or to central banks of the Member States or the European Central Bank as described in paragraph 1, and their right or that of any nominee, agent or third party acting on their behalf</p>	1999 Regulations, regulation 23, as amended by regulation 2(15) of the Amending Regulations	The Treasury

Article / paragraph	Full text of the provision	Relevant domestic provision	Responsibility
	with respect to the securities is legally recorded on a register, account or centralised deposit system located in a Member State, the determination of the rights of such entities as holders of collateral security in relation to those securities shall be governed by the law of that Member State."		
Article 1(11)	(11) Article 10 shall be replaced by the following: "Article 10 1. Member States shall specify the systems, and the respective system operators, which are to be included in the scope of this Directive and shall notify them to the Commission and inform the Commission of the authorities they have chosen in accordance with Article 6(2).	1999 Regulations, regulation 3, and 4, as amended by regulation 2(3) of the Amending Regulations	The Treasury
	The system operator shall indicate to the Member State whose law is applicable the participants in the system, including any possible indirect participants, as well as any change in them.	1999 Regulations, regulation 10, as amended by regulation 2(9) of the Amending Regulations	The Treasury
	In addition to the indication provided for in the second subparagraph, Member States may impose supervision or authorisation requirements on systems which fall under their jurisdiction.	1999 Regulations, regulation 4 and Schedule to the Regulations	The Treasury
	An institution shall, on request, inform anyone with a legitimate interest of the systems in which it participates and provide information about the main rules governing the functioning of those systems.	1999 Regulations, Schedule, paragraph 5(2)	The Treasury
	2. A system designated prior to the entry into force of national provisions implementing Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims [] shall continue to be designated for the purposes of this Directive.	Amending Regulations, regulation 3	The Treasury
	A transfer order which enters a system before the entry into force of national provisions implementing Directive 2009/44/EC, but is settled thereafter shall be deemed to be a transfer order for the purposes of this Directive.	A transfer order executed under the 1999 Regulations as currently in force will be a transfer order under the 1999 Regulations as amended, so no further implementation is needed	The Treasury

Article / paragraph	Full text of the provision	Relevant domestic provision	Responsibility
Article 2(4)	<p>(4) Article 1 shall be amended as follows:</p> <p>(a) paragraph 2(b) shall be replaced by the following:</p> <p>"(b) a central bank, the European Central Bank, the Bank for International Settlements, a multilateral development bank as referred to in Annex VI, Part 1, Section 4 of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) [], the International Monetary Fund and the European Investment Bank;"</p> <p>(b) in paragraph 2(c), points (i) to (iv) shall be replaced by the following:</p> <p>"(i) a credit institution as defined in Article 4(1) of Directive 2006/48/EC, including the institutions listed in Article 2 of that Directive;</p> <p>(ii) an investment firm as defined in Article 4(1)(1) of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments [];</p> <p>(iii) a financial institution as defined in Article 4(5) of Directive 2006/48/EC;</p> <p>(iv) an insurance undertaking as defined in Article 1(a) of Council Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life insurance (third non-life insurance Directive) [] and an assurance undertaking as defined in Article 1(1)(a) of Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance [];"</p>	2003 Regulations, regulation 2 (definitions of "title transfer financial collateral arrangements" and "security financial collateral arrangement" and "non-natural person")	The Treasury
Article 2(4)(c)	<p>(c) paragraph 4(a) shall be replaced by the following:</p> <p>"(a) The financial collateral to be provided shall consist of cash, financial instruments or credit claims;"</p>	2003 Regulations, regulation 3, definition of "financial collateral" as amended by regulation 4(2)(b)(ii) of the Amending Regulations	The Treasury

Article / paragraph	Full text of the provision	Relevant domestic provision	Responsibility
Article 2(4)(d)	<p>(d) in paragraph 4, the following point shall be added:</p> <p>"(c) Member States may exclude from the scope of this Directive credit claims where the debtor is a consumer as defined in Article 3(a) of Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers [] or a micro or small enterprise as defined in Article 1 and Article 2(2) and (3) of the Annex to Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises [], save where the collateral taker or the collateral provider of such credit claims is one of the institutions referred under Article 1(2)(b) of this Directive.</p>	The United Kingdom has not exercised this option	The Treasury
Article 2(4)(e)(i)	<p>(e) paragraph 5 shall be amended as follows:</p> <p>(i) in the second subparagraph, the following sentence shall be added:</p> <p>"For credit claims, the inclusion in a list of claims submitted in writing, or in a legally equivalent manner, to the collateral taker is sufficient to identify the credit claim and to evidence the provision of the claim provided as financial collateral between the parties.";</p>	This already applies under existing UK law	The Treasury
Article 2(4)(e)(ii)	<p>(ii) the following subparagraph shall be inserted after the second subparagraph:</p> <p>"Without prejudice to the second subparagraph, Member States may provide that the inclusion in a list of claims submitted in writing, or in a legally equivalent manner, to the collateral taker is also sufficient to identify the credit claim and to evidence the provision of the claim provided as financial collateral against the debtor or third parties.".</p>	This already applies under existing UK law	The Treasury
Article 2(5)(a)(i)	<p>(5) Article 2 shall be amended as follows:</p> <p>(a) paragraph 1 is amended as follows:</p> <p>(i) points (b) and (c) shall be replaced by the following:</p> <p>"(b) "title transfer financial collateral arrangement" means an arrangement, including repurchase agreements, under which a collateral provider transfers full ownership of, or full entitlement to, financial collateral to a collateral taker for the purpose of securing or otherwise covering the performance of relevant financial obligations;</p>	2003 Regulations, regulation 3(1), definition of "title transfer financial collateral arrangement"	The Treasury

Article / paragraph	Full text of the provision	Relevant domestic provision	Responsibility
Article 2(5)(a)(i)	(c) "security financial collateral arrangement" means an arrangement under which a collateral provider provides financial collateral by way of security to or in favour of a collateral taker, and where the full or qualified ownership of, or full entitlement to, the financial collateral remains with the collateral provider when the security right is established;"	2003 Regulations, regulation 3(1), definition of "security financial collateral arrangement", as amended by regulation 4(2)(b)(iv) of the Amending Regulations	The Treasury
Article 2(5)(a)(ii)	(ii) the following point shall be added: "(o) "credit claims" means pecuniary claims arising out of an agreement whereby a credit institution, as defined in Article 4(1) of Directive 2006/48/EC, including the institutions listed in Article 2 of that Directive, grants credit in the form of a loan.";	2003 Regulations, regulation 3(1) definition of "credit claim", as inserted by regulation 4(2)(b)(i) of the Amending Regulations	The Treasury
Article 2(5)(b)	(b) in paragraph 2, the second sentence shall be replaced by the following: "Any right of substitution, right to withdraw excess financial collateral in favour of the collateral provider or, in the case of credit claims, right to collect the proceeds thereof until further notice, shall not prejudice the financial collateral having been provided to the collateral taker as mentioned in this Directive."	2003 Regulations, regulation 3(1), definitions of "title transfer collateral arrangement" and "security financial collateral arrangement"	The Treasury
Article 2(6)(a)	(6) Article 3 shall be amended as follows: (a) in paragraph 1, the following subparagraphs shall be added: "Without prejudice to Article 1(5), when credit claims are provided as financial collateral, Member States shall not require that the creation, validity, perfection, priority, enforceability or admissibility in evidence of such financial collateral be dependent on the performance of any formal act such as the registration or the notification of the debtor of the credit claim provided as collateral. However, Member States may require the performance of a formal act, such as registration or notification, for purposes of perfection, priority, enforceability or admissibility in evidence against the debtor or third parties. By 30 June 2014, the Commission shall report to the European Parliament and to the Council on whether this paragraph continues to be appropriate.";	2003 Regulations, regulations 4, 5, 6, and 6A, as amended by regulation 4(3), (4) and (5) of the Amending Regulations, prevent legislation and common law rules which would impose requirements for formalities from applying to financial collateral arrangements.  Requirements in section 136 of the Law of Property Act 1925 for notification of the assignment of credit claims guarantee to ensure enforceability against the debtor and any third party guarantor are being maintained.	The Treasury

Article / paragraph	Full text of the provision	Relevant domestic provision	Responsibility
Article 2(6)(b)	<p>(b) the following paragraph shall be added:</p> <p>"3. Without prejudice to Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts [] and national provisions concerning unfair contract terms, Member States shall ensure that debtors of the credit claims may validly waive, in writing or in a legally equivalent manner:</p> <p>(i) their rights of set-off vis-à-vis the creditors of the credit claim and vis-à-vis persons to whom the creditor assigned, pledged or otherwise mobilised the credit claim as collateral; and</p> <p>(ii) their rights arising from banking secrecy rules that would otherwise prevent or restrict the ability of the creditor of the credit claim to provide information on the credit claim or the debtor for the purposes of using the credit claim as collateral.</p>	<p>This already applies under UK law. No further action is necessary</p>	<p>The Treasury</p>
Article 2(7)	<p>(7) Article 4 shall be amended as follows:</p> <p>(a) in paragraph 1, the following point shall be added:</p> <p>"(c) credit claims, by sale or appropriation and by setting off their value against, or applying their value in discharge of, the relevant financial obligations.";</p> <p>(b) in paragraph 2, point (b) shall be replaced by the following:</p> <p>"(b) the parties have agreed in the security financial collateral arrangement on the valuation of the financial instruments and the credit claims.";</p> <p>(c) paragraph 3 shall be deleted.</p>	<p>This method of realising credit claims provided as financial collateral under a security collateral arrangement is available and recognised under UK law, and no further action is necessary</p> <p>2003 Regulations, regulations 18, and .2 (definition of financial collateral,, as amended by regulation 4(2)(b)(ii))</p>	<p>The Treasury</p>
Article 2(8)	<p>(8) In Article 5, the following paragraph shall be added:</p> <p>"6. This Article shall not apply to credit claims."</p>	<p>2003 Regulations, regulation 16(5), as inserted by regulation 4(14) of the Amending Regulations</p>	<p>The Treasury</p>





<b>Title:</b> <b>Impact assessment of UK implementation regulations of the EU directive on settlement finality and financial collateral arrangements.</b>  <b>Lead department or agency:</b> HM Treasury <b>Other departments or agencies:</b>	<b>Impact Assessment (IA)</b>
	<b>IA No:</b>
	<b>Date:</b> 10/12/2010
	<b>Stage:</b> Development/Options
	<b>Source of intervention:</b> EU
	<b>Type of measure:</b> Secondary legislation
<b>Contact for enquiries:</b> Helena Forrest 0207 270 5694	

## Summary: Intervention and Options

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

In April 2008 the Commission decided to amend the Settlement Finality Directive (SFD) and the Financial Collateral Arrangements Directive (FCD), bringing both Directives in line with market and regulatory developments in the post-trading area. The SFD aimed to reduce the systemic risk associated with participation in payment and securities settlement systems and FCD sought to expand on the role of collateral in SFD. These directives provide a key underpinning for the systemic robustness of the financial markets.

The Government now has to implement the directive to meet the European deadline of 30 December 2010, and is proposing to do this by amending existing domestic legislation.

### What are the policy objectives and the intended effects?

The Commission produced a report in 2005 on the operation of the SFD and in 2006 on the operation of the FCD. Both reports concluded that the Directives had proved a success. However, some improvements were identified. The objectives of the amending Directive are to increase the efficiency and safety of the EU financial market and ensure a level playing field among the relevant participants, principally by facilitating the use of credit claims as collateral, ensuring the stability of settlement systems, and enhancing legal certainty. The proposed UK implementation regulations brings this into effect so UK industry stakeholders can benefit from these changes and work more effectively in a changing post trade environment.

### What policy options have been considered? Please justify preferred option (further details in Evidence Base)

- 1) To amend the Financial Markets and Insolvency Regulations (1999) and the Financial Collateral Arrangements (No.2) Regulations 2003 in order to comply with the European Directive 2009/44/EC.
- 2) Not to implement.

Option 1 is preferred in view of the EU requirement to adopt and publish the laws, regulations and administrative provisions, necessary to comply with this Directive by 30 December 2010. The Directive will apply from 30 June 2011.

<b>When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?</b>	It will be reviewed in 5 years
<b>Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?</b>	Yes

**Ministerial Sign-off** For consultation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible Minister:  Date: 13/12/10



# Summary: Analysis and Evidence

# Policy Option 1

## Description:

Impact of amending Financial Markets and Insolvency Regulations (1999) and the Financial Collateral Arrangements (No.2) Regulations 2003

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: 0.5bn	High: £35bn	Best Estimate: £15bn

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0	0	0
High	£10m	0	£1m
Best Estimate	500k	0	500k

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

The principal monetised costs relate to system costs.

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

In the area of credit claims there could be indirect costs relating to any disadvantage suffered to creditors in the event of the insolvency of a company that has used credit claims as collateral.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	£0.5bn	TBC	£0.5bn
High	£35bn	TBC	£35bn
Best Estimate	£15bn	TBC	£15bn

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

The European Commission has estimated the potential benefits for the euro area from bringing credit claims into the scope of the Financial Collateral Directive may amount to between Euro 3.5bn and Euro 263billion. The assumptions behind this estimate are outlined in the Commission's impact assessment on its proposals (link on p 3). A simple adjustment based on the relative size of UK and Eurozone GDP would suggest this figure might be E0.5bn to E35bn for the UK.

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

The implementation of the Amending Directive should offer benefits from reduced legal risk, reduced risk of systemic disruption to the key financial architecture of London's markets and potentially reduced funding costs in the form of collateral savings and additional liquidity available to financial institutions.

### Key assumptions/sensitivities/risks

Discount rate (%) 3.5

Impact on admin burden (AB) (£m):		Impact on policy cost savings (£m):		In scope
New AB:	AB savings:	Net:	Policy cost savings:	Yes/No

## Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?	United Kingdom				
From what date will the policy be implemented?	30/06/2011				
Which organisation(s) will enforce the policy?	UK courts/FSA				
What is the annual change in enforcement cost (£m)?	0				
Does enforcement comply with Hampton principles?	Yes				
Does implementation go beyond minimum EU requirements?	No				
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)	Traded:		Non-traded:		
Does the proposal have an impact on competition?	No				
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?	Costs:		Benefits:		
Annual cost (£m) per organisation (excl. Transition) (Constant Price)	Micro	< 20	Small	Medium	Large
Are any of these organisations exempt?	No	No	No	No	No

## Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on...?	Impact	Page ref within IA
<b>Statutory equality duties<sup>1</sup></b> <a href="#">Statutory Equality Duties Impact Test guidance</a>	No	
<b>Economic impacts</b>		
Competition <a href="#">Competition Assessment Impact Test guidance</a>	No	
Small firms <a href="#">Small Firms Impact Test guidance</a>	No	
<b>Environmental impacts</b>		
Greenhouse gas assessment <a href="#">Greenhouse Gas Assessment Impact Test guidance</a>	No	
Wider environmental issues <a href="#">Wider Environmental Issues Impact Test guidance</a>	No	
<b>Social impacts</b>		
Health and well-being <a href="#">Health and Well-being Impact Test guidance</a>	No	
Human rights <a href="#">Human Rights Impact Test guidance</a>	No	
Justice system <a href="#">Justice Impact Test guidance</a>	No	
Rural proofing <a href="#">Rural Proofing Impact Test guidance</a>	No	
<b>Sustainable development</b> <a href="#">Sustainable Development Impact Test guidance</a>	No	

<sup>1</sup> Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.



## Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

### References

Include the links to relevant legislation and publications, such as public impact assessment of earlier stages (e.g. Consultation, Final, Enactment).

No.	Legislation or publication
1	EU impact assessment <a href="http://ec.europa.eu/internal_market/financial-markets/docs/proposal/impact_en.pdf">http://ec.europa.eu/internal_market/financial-markets/docs/proposal/impact_en.pdf</a>
2	EU amending directive 2009/44/EC <a href="http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:146:0037:0043:EN:PDF">http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:146:0037:0043:EN:PDF</a>
3	Settlement Finality Directive 98/26/EC <a href="http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:1998:166:0045:0050:EN:PDF">http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:1998:166:0045:0050:EN:PDF</a>
4	Financial Collateral Arrangements Directive 2002/47/EC <a href="http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2002:168:0043:0050:EN:PDF">http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2002:168:0043:0050:EN:PDF</a>
5	The Financial Collateral Arrangements regulations 2003 Impact Assessment <a href="http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/d/idfca_ria_0104.pdf">http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/d/idfca_ria_0104.pdf</a>

### Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

#### Annual profile of monetised costs and benefits\* - (£m) constant prices

	Y <sub>0</sub>	Y <sub>1</sub>	Y <sub>2</sub>	Y <sub>3</sub>	Y <sub>4</sub>	Y <sub>5</sub>	Y <sub>6</sub>	Y <sub>7</sub>	Y <sub>8</sub>	Y <sub>9</sub>
<b>Transition costs</b>										
<b>Annual recurring cost</b>										
<b>Total annual costs</b>										
<b>Transition benefits</b>										
<b>Annual recurring benefits</b>										
<b>Total annual benefits</b>										

\* For non-monetised benefits please see summary pages and main evidence base section



## Evidence Base (for summary sheets)

### Background to the amending Directive (2009/44/EC)

On 6 May 2009 the European Parliament and Council adopted the Directive 2009/44/EC, which amends Directive 98/26/EC on settlement finality in payment and securities settlement systems, and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims. Member states have until 30 December 2010 to adopt and publish the laws, regulations and administrative provisions, necessary to comply with this Directive, which will apply from 30 June 2011.

The Settlement Finality Directive (98/26/EC) was adopted in 1998, in order to reduce the systemic risk associated with participation in payment and securities settlement systems. Since 1998, the post-trading environment has changed considerably. When the original SFD was passed, systems operated on an almost exclusively national and independent basis. However since then systems have become increasingly linked /interoperable. In 2005, the Commission published an evaluation report and concluded that certain parts of the Directive needed to be revisited and amended.

The Financial Collateral Arrangements Directive (2002/47/EC) sought to expand on the role of collateral from the Settlement Finality Directive. The objective was to achieve greater integration and cost –efficiency of European financial markets, by simplifying the collateral process, improving legal certainty in the use of collateral and reducing risks for market participants. In December 2006, the European Commission published an evaluation report, which concluded that the directive was largely working well, but that some aspects would benefit from revision.

Due to the close links between the Settlement Directive and the Financial Collateral Arrangements Directive, the Commission concluded that both directives should be amended together under Directive 2009/44/EC.

These implementation regulations seek to amend the UK Financial Markets and Insolvency Regulations 1999, and the Financial Collateral Arrangements (No.2) Regulations 2003 in order to comply with the European Amending Directive 2009/44/EC.

### Option 1 - To amend the Financial Markets and Insolvency Regulations (1999) and the Financial Collateral Arrangements (No.2) Regulations 2003 in order to comply with the European Directive 2009/44/EC.

#### **Group of Measures 1: Introducing the concept of interoperable systems into law**

*Benefits:* The Amending Directive changes various definitions and introduces various terms to ensure interoperable systems are brought into the regime with relevant protections clarified or extended where appropriate. At present, it is unclear whether interlinked systems fully benefit from the protections of the Settlement Finality Directive. By thus reducing the legal uncertainty surrounding the protections enjoyed by systems (e.g. clearing houses, settlement agents), which are linked to other systems, the risk of contagion in the financial system should be reduced. As such systems are vital for the proper functioning of financial markets, a contagion spreading through interlinked settlement systems could, in a worst-case scenario, cause widespread failures, leading to billions of pounds of costs.

As an illustration of the importance of maintaining the resilience of the systems designated under the SFD, we note that for example CHAPS handled an average daily value of £255 billion in 2009; representing almost 20% of annual UK GDP. Meanwhile the daily average value of cash moving through CREST was in the order of £908 billion in March 2010, including self-collateralising repo transactions.

*Costs:* These changes are clarifying ones and we have not identified any costs associated with them

#### **Group of Measures 2: Providing clarity on calendar days and moments of entry**

*Benefits:* The Directive clarifies that the SFD's protections apply to settlements that take place on the same business day as an insolvency is initiated, and obliges settlement systems to seek to co-ordinate their rules regarding the moment of entry and irrevocability of transfer orders. As with the measures outlined above, by reducing the legal uncertainty surrounding the protections enjoyed by systems (e.g.



clearing houses, settlement agents) which are linked to other systems, the risk of contagion in the financial system should be reduced. As such systems are vital for the proper functioning of financial markets, a contagion spreading through interlinked settlement systems could, in a worst case scenario, cause widespread, leading to billions of pounds of costs.

**Costs:** this could mean some implementation costs to industry, which we would not expect to be unduly burdensome. Systems which are interlinked will need to take steps to ensure that their rules governing the moment of entry and irrevocability of transfer orders are co-ordinated as far as possible. We are using the consultation process to seek more information from industry on the nature and scale of these costs, but have estimated them as between £0m and £10m in the meantime.

### **Group of Measures 3: Bringing credit claims into the scope of the FCD**

*Benefits:* The Directive brings credit claims into the scope of the FCD's protections. The intention of this measure is to increase the pool of available collateral that banks can use. In principle, the availability of credit claims as a form of collateral could decrease the cost of funding for credit institutions, thus increasing lending with associated economic benefits. The Eurosystem has since 2007 accepted credit claims as collateral in its credit operations. Certain EU countries (such as Luxembourg) already include credit claims in the scope of their implementation of the FCD, meaning that implementation of the Amending Directive will put relevant UK entities on a level playing field with Entities in other EU jurisdictions. The European Commission has estimated (see reference 1 in list above) that the measure may benefit Euro area countries by E3.5bn to E263bn, in the form of collateral savings/additional liquidity available to financial institutions. (This estimate takes into account only the first-round effects and does not include any additional benefits that could come from financial institutions using this liquidity to fuel their businesses.) These potential benefits are of increased relevance to the UK in light of the Bank of England's announcement that it will accept credit claims as collateral for its Discount Window Facility. A simplistic adjustment based on the relative size of UK and Eurozone GDP would suggest this figure might be E0.5bn to E35bn for the UK. No comments were made on this estimate during the consultation stage.

*Costs:* There may be costs among industry relating to implementing systems for handling credit claims in case such systems are not already in place, although it should be borne in mind that there is no obligation for industry to use credit claims as collateral. In addition it can be observed that in the extended regime, if a credit institution were to go bankrupt, any credit claims pledged as collateral would not be available to repay the institution's creditors, disadvantaging those creditors versus a situation in which they had a claim on the collateral.

#### Option 2 – Not to implement

*Benefits:* Existing legislation would stay the same for the industry. The costs described above would not accrue.

*Costs:* The risks described above would not be addressed. In addition the UK runs the risk of infraction proceedings being initiated by the European Commission if we do not meet the implementation date of 31 December 2010.



## Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added where the Specific Impact Tests yield information relevant to an overall understanding of policy options.

### Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

**Basis of the review:** [The basis of the review could be statutory (forming part of the legislation), it could be to review existing policy or there could be a political commitment to review];

Within 5 years of the implementation of the statutory instrument the Treasury will review the implementing regulations.

**Review objective:** [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?]

To ensure that the regulations remain an appropriate method of implementing the Amending Directive.

**Review approach and rationale:** [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach]

Treasury officials will seek views of relevant stakeholders, such as system operators, the Bank of England and the FSA.

**Baseline:** [The current (baseline) position against which the change introduced by the legislation can be measured]

**Success criteria:** [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives]

The Treasury and stakeholders consider that the implementing regulations continue to satisfactorily implement the provisions of the amending directive.

**Monitoring information arrangements:** [Provide further details of the planned/existing arrangements in place that will allow a systematic collection of monitoring information for future policy review]

Treasury officials are in regular contact with affected stakeholders.

**Reasons for not planning a PIR:** [If there is no plan to do a PIR please provide reasons here]

