

**EXPLANATORY MEMORANDUM TO
THE FINANCIAL SERVICES AND MARKETS ACT 2000 (REGULATED ACTIVITIES)
(AMENDMENT) ORDER 2012**

2012 No. 1906

**THE TERRORISM ACT 2000 AND PROCEEDS OF CRIME ACT 2002 (BUSINESS IN
THE REGULATED SECTOR) ORDER 2012**

2012 No. 1534

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

2. Purpose of the instrument

2.1 The purpose of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2012 ("the RAO Amendment Order"), and the Terrorism Act 2000 and Proceeds of Crime Act 2002 (Business in the Regulated Sector) Order 2012 ("the Regulated Sector Order") is to implement Articles 6(5), 18, 55 and 59 of Commission Regulation (EU) 1031/2010 on the timing, administration and other aspects of auctioning of greenhouse gas allowances (OJ L 302, 18.11.2010, p.1) ("the EU Auctioning Regulation") by providing for the authorisation of certain categories of bidder by the Financial Services Authority, and for the application of civil penalties for the breach of certain provisions of that Regulation.

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

3.1 None.

4. Legislative Context

4.1 The regulatory framework for auctioning aviation and phase III emissions allowances under the EU Emissions Trading System is contained in the EU Auctioning Regulation. The Recognised Auction Platforms Regulations 2011 (S.I. 2011/2699) and the Terrorism Act 2000 and Proceeds of Crime Act 2002 (Business in the Regulated Sector) Order 2011 (S.I. 2011/2701) implemented Articles 35, 36, 43 and 55 of the EU Auctioning Regulation by providing for the authorisation and regulation of auction platforms auctioning such allowances, and for the extension of UK law implementing EU law on regulated markets in financial instruments, market abuse, money laundering and terrorist financing to apply to such auction platforms.

4.2 The RAO Amendment Order implements Article 18 of the EU Auctioning Regulation, which sets out the persons eligible to apply for admission to bid in auctions of

emissions allowances. Certain categories of persons are only eligible to bid if the Member State in which the person is established has enacted legislation enabling the relevant competent authority (the Financial Services Authority (“FSA”) for persons in the UK) to authorise them to bid. The RAO Amendment Order makes bidding in an auction of emissions allowances a regulated activity for purposes of the Financial Services and Markets Act (Regulated Activities) Order 2001 (S.I. 2001/544) (“the RAO”), subject to exclusions made for those persons not required by Article 18 to be separately authorised. The Money Laundering Regulations 2007 (S.I. 2007/2157) (“the 2007 Regulations”) are amended so that a person bidding on behalf of others in such an auction must comply with the requirements of the 2007 Regulations, which is a condition of authorisation under the EU Auctioning Regulation.

4.3 The RAO Amendment Order also amends Schedule 3 to the Financial Services and Markets Act 2000 (c. 8) (“FSMA”) to provide for bidders authorised in other EU Member States to bid in UK auctions and vice versa; it amends the 2007 Regulations and the Recognised Auction Platform Regulations 2011 (S.I. 2011/2699) to provide for the FSA to be able to impose civil penalties for breach of certain provisions of the EU Auctioning Regulation as required by Article 55 of that Regulation; and it makes related and consequential amendments to FSMA and to other secondary legislation made under that Act.

4.4 The Regulated Sector Order amends the definition of a business in the regulated sector for the purposes of Part 3 of the Terrorism Act 2000 (terrorist property) (c.11) and Part 7 of the Proceeds of Crime Act 2002 (money laundering) (c.29) by adding the activity of bidding on behalf of others in an auction of emissions allowances. Those Parts contain provisions relating to the reporting of suspicious activity, including requirements and offences specific to “the regulated sector”. Compliance with these requirements is also a condition of authorisation under the EU Auctioning Regulation.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 The Financial Secretary to the Treasury, Mark Hoban, has made the following statement regarding Human Rights:

“In my view the provisions of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2012, and of the Terrorism Act 2000 and Proceeds of Crime Act 2002 (Business in the Regulated Sector) Order 2012, are compatible with the Convention rights.”

7. Policy background

- *What is being done and why*

7.1 The EU Auctioning Regulation concerns the auctioning of emissions allowances under the EU Emissions Trading System (“EU ETS”).

7.2 The EU ETS is at the heart of UK Government policy to tackle climate change. The system covers sectors responsible for around half of the UK’s carbon dioxide emissions. The EU ETS is expected to deliver annual carbon savings of 51 mega tonnes of carbon dioxide in 2020—a reduction in the emissions of the power sector and heavy industry of 22 per cent based on 2008 levels.

7.3 The EU ETS works on a “cap and trade” basis. A cap is set on EU Member States’ emissions, which declines over time. Emissions allowances equal to each year’s cap are then issued and allocated to sectors covered by the system. Allowances can be allocated for free or auctioned by national governments.

7.4 The next phase (phase III) of the EU ETS begins in 2013. Phase III of the EU ETS will see a dramatic rise in the level of auctioning. The EU Auctioning Regulation sets out the European regulatory framework for auctioning emissions allowances in phase III.

7.5 The recitals to the EU Auctioning Regulation explain that confidence in the integrity of the EU ETS auction processes is a prerequisite for ensuring auction participation and a competitive auction outcome. Bidders in auctions should therefore be subject to minimum requirements for adequate customer due diligence checks.

7.6 To achieve this in a cost-effective way, eligibility to apply for admission to bid in auctions of emissions allowances is restricted to certain defined groups of participants. These are set out in Article 18 of the EU Auctioning Regulation and are:

- i. Operators of installations or aircraft operators covered by the emissions trading scheme (essentially users of emissions allowances who need to buy allowances for compliance purposes) or groups of such operators or public bodies that control them.
- ii. Investment firms or credit institutions authorised under the Markets in Financial Instruments Directive (2004/39/EC) (“MiFID”) or the Capital Requirements Directive (2006/48/EC).
- iii. Persons who are covered by the exemption in Article 2(1)(i) of MiFID for dealing on their own account in financial instruments where this is ancillary to their main business.

7.7 Eligibility for persons in (iii) is dependent on the Member State in which the person is established having enacted legislation enabling the relevant competent authority (the FSA for persons in the UK) to authorise them to bid. Where investment firms or

credit institutions under (ii) are bidding, on behalf of others, for auctioned products that are not financial instruments, eligibility is similarly dependent on legislation to enable the competent authority to grant authorisation. The RAO Amendment Order implements this requirement by making bidding in auctions of emissions allowances a regulated activity for persons in the relevant categories, which requires them to apply for FSA authorisation to participate.

7.8 Article 6(5) of the EU Auctioning Regulation deems the reception, transmission and submission of a bid by an investment firm or credit institution on any auction platform to be an investment service within the meaning of MiFID where the auctioned product is a financial instrument, extending the MiFID regulatory regime to apply to such activities. The RAO Amendment Order implements this requirement by changing the definition of “investment services and activities” in the RAO.

7.9 Article 55(1) of the EU Auctioning Regulation requires Member States to impose civil penalties on auction platforms that infringe certain provision of the Regulation. This requirement was partly implemented by S.I. 2011/2699 and S.I. 2011/2701, and is further implemented by Articles 7 and 8 of the RAO Amendment Order.

7.10 Article 59 of the EU Auctioning Regulation sets out conduct rules for persons authorised to bid on behalf of others. The rules require (among other things) that such persons must comply with the requirements of Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (“the Third Money Laundering Directive”), which is implemented in the UK by the Terrorism Act 2000, the Proceeds of Crime Act 2002 and the 2007 Regulations. Article 7 of the RAO Amendment Order, and the Regulated Sector Order, implement this requirement.

- ***Consolidation***

7.11 The Treasury does not have plans to consolidate FSMA, the RAO or other secondary legislation made under FSMA at this time. Commercial publishers produce consolidated versions of FSMA, and of secondary legislation made under it, both in electronic and hard copy versions.

7.12 A review of the 2007 Regulations is currently underway and amendments to the legislation are being considered as part of that review.

8. Consultation outcome

8.1 The Treasury conducted a public consultation from 14 February until 10 April 2012, including publication of a draft of these Orders. Only one response was received, and it did not raise any issues with respect to the proposed legislative approach.

9. Guidance

9.1 The FSA will provide guidance in the FSA handbook.

10. Impact

10.1 A minimal impact on business, charities or voluntary bodies is foreseen. We anticipate that only around 20 firms in total will need to seek authorisation. See impact assessment for detail.

10.2 No impact on the public sector is foreseen.

10.3 An Impact Assessment is attached to this memorandum and will be published alongside the Explanatory Memorandum on www.legislation.gov.uk.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 To minimise the impact of the requirements on firms employing up to 20 people, the approach taken is proportionate.

11.3 The EU Auctioning Regulation does not provide any basis for excluding small or micro businesses from regulation. In practice we consider it highly unlikely that any micro firm would wish to become authorised in relation to auctions of emissions allowances.

12. Monitoring & review

12.1 The Treasury is required to review the operation and effect of the RAO Amendment Order and the Regulated Sector Order within five years from the date on which they come into force, and publish a report.

13. Contact

Imran Shafi at HM Treasury Tel: 020 7270 4803 or email:

Imran.Shafi@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.

IMPLEMENTING COMMISSION REGULATION 1031/2010 - A TRANSPOSITION NOTE

Commission Regulation 1031/2010 of 12 November 2010 on the timing, administration and other aspects of auctioning of greenhouse gas emission allowances

Abbreviations:

“2011 Regulations” means the Recognised Auction Platforms Regulations 2011

“RA Order” means the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2012

“BRS Order” means the Terrorism Act 2000 and Proceeds of Crime Act 2002 (Business in the Regulated Sector) Order 2012

Article	Full text of the provision	Relevant domestic provision
Article 6(5)	The reception, transmission and submission of a bid by an investment firm or credit institution on any auction platform shall be deemed to constitute an investment service within the meaning of point 2 of Article 4(1) of Directive 2004/39/EC where the auctioned product is a financial instrument.	RA Order, article 2(2)(a)
Article 18	<p>Persons eligible to bid</p> <p>1. The following persons shall be eligible to apply for admission to bid directly in auctions</p> <ul style="list-style-type: none"> a) An operator or an aircraft operator having an operator holding account, bidding on its own account, including any parent undertaking, subsidiary undertaking or affiliate undertaking forming part of the same group of undertakings as the operator or the aircraft operator; b) Investment firms authorised under Directive 2004/39/EC bidding on their own account or on behalf of their clients; c) Credit institutions authorised under Directive 2006/48/EC bidding on their own account or on behalf of their clients; d) Business groupings of persons listed in point (a) bidding on their own account and acting as an agent on behalf of their members; e) Public bodies or state-owned entities of the member States that control any of the persons listed in point (a). <p>2. Without prejudice to the exemption in Article 2(1)(i) of Directive 2004/39/EC, persons covered by this exemption and authorised pursuant to Article 59 of this Regulation shall be eligible to apply for permission to bid directly in the auctions either on their own account or on behalf of clients of their main business provided that a Member State where they are established has enacted legislation enabling the relevant competent</p>	RA Order, articles 2(3), 2(4), 3 and 4

	<p>national authority in that Member State to authorise them to bid on their own account or on behalf of clients of their main business.</p> <p>3. Persons referred to in paragraph 1(b) or (c) shall be eligible to apply for admission to bid directly in the auctions on behalf of their clients when bidding for auctioned products that are not financial instruments provided that a Member State in which they are established has enacted legislation enabling the relevant competent national authority in that member State to authorise them to bid on behalf of their clients.</p>	<p>RA Order, articles 2(3), 2(4), 3 and 4</p>
Article 55	<p>1. The competent national authorities referred to in Article 37(1) of Directive 2005/60/EC shall monitor and take the necessary measures to ensure compliance of an auction platform auctioning two-day spot or five-day futures with the customer due diligence requirements of Article 19 and Article 20(6) of this Regulation, the monitoring and record keeping requirements of Article 54 of this Regulation and the notification requirements of the paragraphs 2 and 3 of this Article.</p> <p>The competent national authorities referred to in the first subparagraph shall have the powers provided for in the national measures transposing Article 37(2) and (3) of Directive 2005/60/EC.</p> <p>An auction platform auctioning two-day spot or five-day futures may be held liable for infringements of Article 19, Articles 20(6) and (7) and 21(1) and (2), and Article 54 of this Regulation and paragraphs 2 and 3 of this Article. The national measures transposing Article 39 of Directive 2005/60/EC shall apply in this regard.</p>	<p>2011 Regulations, regulation 11</p> <p>RA Order, article 8</p>
Article 59	<p>5. The competent national authorities referred to in paragraph 4 shall only grant an authorisation to the persons referred to in paragraph 1 where the persons fulfil all of the following conditions:</p> <p>....</p> <p>(c) they comply with the requirements of national legislation transposing Directive 2005/60/EC;</p>	<p>RA Order, article 7</p> <p>BRS Order, articles 2 and 3.</p>