

**EXPLANATORY MEMORANDUM TO
THE FINANCIAL SERVICES ACT 2012 (MISLEADING STATEMENTS AND
IMPRESSIONS) ORDER 2013**

2013 No. 637

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 This Order specifies the relevant activities, investments and benchmarks, for the purposes of criminal offences in Part 7 of the Financial Services Act 2012 (“the Act”). Initially, the benchmark to come within scope will be the London Interbank Offer Rate (known as “LIBOR”); the agreement and investments specified replicate those contained in the Financial Services and Markets Act 2000 (Misleading Statements and Practices) Order 2001 which was made under section 397 of the Financial Services and Markets Act 2000 (“FSMA”) which is repealed by the Act.

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

- 3.1 None

4. **Legislative Context**

- 4.1 Sections 89 and 90 of the Act in part replicate the effect of section 397 of FSMA, which is repealed by section 95 of the Act. The Order specifies activities and investments which are relevant for the purposes of the offences created by sections 89 and 90. The provisions of the Order replicate the effect of the Financial Services and Markets Act 2000 (Misleading Statements and Practices) Order 2001 which was made under section 397 of FSMA. That Order falls away consequent on the repeal of section 397 of FSMA.

- 4.2 Section 91 of the Act creates a new offence relating to the making of a misleading statement or the creation of a false or misleading impression in relation to a “relevant benchmark” (that is, a benchmark of a kind specified in an Order made by the Treasury).

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 has made the following statement regarding Human Rights:

6.2 In my view the provisions of the Financial Services Act 2012 (Misleading Statements and Impressions) Order 2013 are compatible with the Convention rights

7. Policy background

7.1 LIBOR refers to a series of interest rate benchmarks. It is estimated that LIBOR is referenced in at least \$300 trillion-worth of financial contracts, both retail and wholesale, globally. In June 2012, it was revealed that LIBOR had been subject to repeated attempts at manipulation, as a result of the conclusion of investigations by the Financial Services Authority (FSA) and other international public authorities. Further investigations are underway.

7.2 Subsequently, the Chancellor of the Exchequer asked Martin Wheatley, to commence an independent review into the setting and usage of LIBOR, which is vital to the functioning of global financial markets. The findings and recommendations of the Wheatley Review were published on 28 September 2012 and can be found on the HM Treasury website, here: http://cdn.hm-treasury.gov.uk/wheatley_review_libor_finalreport_280912.pdf.

7.3 The Review identified a number of failings in the production and oversight of the process of determining LIBOR, which is currently administered by the British Bankers Association (BBA) and self-regulated by the BBA and the contributing banks. In particular, the Review noted that the FSA's existing market abuse regime and the existing offences under FSMA do not extend to misconduct in respect of benchmarks, such as LIBOR.

7.4 Consequently, a key recommendation of the Wheatley Review was that a specific criminal offence be created relating to false or misleading statements or impressions to benchmarks. Additionally, the Wheatley Review recommended that existing criminal sanctions under FSMA be reviewed to ensure their continued workability. As a result, three criminal offences were created in Part 7 of the Financial Services Act 2012:

- The first offence largely relates to 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 relates to 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 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

7.5 This Order specifies the relevant activities, investments and benchmarks, for which the criminal offences in Part 7 of the Financial Services Act 2012 apply. Initially, the only benchmark to be specified for this purpose will be LIBOR; the relevant activities and investments replicate those contained in the Financial Services and Markets Act 2000 (Misleading Statements and Practices) Order 2001.

7.6 The Review also recommended that the activities of providing information to, and the administering of, LIBOR become regulated activities under FSMA. The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2013 –the implements the recommendation to bring LIBOR activities within the scope of regulation.

7.7 While LIBOR misconduct may fall within the scope of other criminal offences, it is important that the Financial Conduct Authority, 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.

7.8 At present, the initial benchmarks that are to be brought within the scope of the new criminal offence – and the scope regulation – are LIBOR. However, further benchmarks can be specified, should it become clear that to do so would bridge a gap in the regulatory or enforcement powers of the regulatory authorities. Further work is ongoing, domestically and internationally to assess whether further benchmarks should be specified for this purpose.

8. Consultation outcome

8.1 HM Treasury sought views from the public through a consultation process which lasted for just under 4 weeks and closed on 24 December 2012. The consultation document included a draft of this Order and can be found at: http://www.hm-treasury.gov.uk/d/implementing_wheatley_review281112.pdf.

8.2 In preparing this Order, the Treasury also benefitted from the consultation conducted by the Wheatley Review, which began in August 2012. Indeed, a number of responses to the Treasury consultation stated that they had no further comments to those provided in response to the Wheatley Review.

8.3 In total, 14 respondents provided comments on the draft legislation, ranging from trade associations, banks, regulated investment exchanges, energy firms, financial index providers and commodity price reporting agencies. Two stakeholders also asked to discuss the proposals.

8.4 All respondents supported the overall policy aims of this Order. Most respondents did not provide material comment on this draft Order. However, some respondents considered that other benchmarks should be specified, in addition to LIBOR. However most of these respondents also considered that it was vital for an international consensus

and framework to be developed under the auspices of the International Organisation of Securities Commissions (IOSCO), the Financial Stability Board (FSB) and the European Commission. The Government agrees with this view and considers that the international consensus does not at present support the specification of additional benchmarks for this purpose.

8.5 Many respondents noted the large diversity and variety of benchmarks – both in content and methodologically – that are compiled across the financial services industry. Consequently, some respondents called for a specific taxonomy to be created at an international level (e.g. IOSCO) to help define the categories of benchmarks which ought to be captured by criminal sanctions; in particular, some suggested that an agreed definition of a “systemic” benchmark would be welcome.

9. Guidance

9.1 The Treasury does not consider it appropriate to issue guidance on this Order.

10. Impact

10.1 The impact is restricted to those that commit the offence, the prosecuting authority and HM Courts Service.

10.2 Under the proposal to include LIBOR as the specified benchmark in this Order, it is unlikely that there will be a significant impact on the business for the Courts. It is anticipated that the number of cases is likely to be low, as only 23 banks currently contribute to LIBOR. Moreover, the creation and implementation of the offence is intended to act as a significant deterrent to this type of conduct.

10.3 The implementation of this policy, through this Order, results in a LIBOR framework that is significantly less vulnerable to attempted manipulation since it is subject to a much stronger sanction for misconduct. As a consequence, LIBOR – which is used in at least \$300 trillion-worth of financial contracts – 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.

11. Regulating small business

11.1 This Order applies to small business in that such businesses could commit the offences under Part 7 of the Act. The effect of the Order is likely to be broadly neutral on such businesses. The effect of the Order taken with sections 89 and 90 of the Act largely replicates the effect of section 397 of FSMA, which currently is capable of applying to small businesses. It is highly unlikely that a small business would be affected by this Order taken with section 91 of the Act as the offence created by section 91 relates to those involved in the setting of a benchmark. It is highly unlikely that a small business will be involved in the setting of LIBOR (the only benchmark being specified for the purposes of section 91 of the Act by this Order).

12. Monitoring & review

12.1 The Order and its effect will be monitored by the Treasury.

13. Contact

Chris Goodspeed at HM Treasury Tel: 0207 270 5690 or email:
chris.goodspeed@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.