
DRAFT STATUTORY INSTRUMENTS

2014 No.

**The Financial Services and Markets Act 2000
(Excluded Activities and Prohibitions) Order 2014**

PART 1

GENERAL

Citation, commencement and interpretation

1.—(1) This Order may be cited as the Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014.

(2) This article, articles 2 and 3 and the Schedule to this Order come into force on 1st January 2015.

(3) The other provisions of this Order come into force on 1st January 2019.

(4) In this Order—

“account holder” means any person, other than a relevant financial institution, who has an account with a ring-fenced body⁽¹⁾;

“the Act” means the Financial Services and Markets Act 2000;

“alternative investment fund” means an AIF within the meaning of Article 4(1)(a) of the Directive of the European Parliament and of the Council of 8 June 2011 on alternative investment fund managers⁽²⁾;

“alternative investment fund manager” means an AIFM within the meaning of Article 4(1)(b) of the Directive of the European Parliament and of the Council of 8 June 2011 on alternative investment fund managers;

“building society” means a building society incorporated (or deemed to be incorporated) under the Building Societies Act 1986⁽³⁾;

“capital market arrangement” has the meaning given in paragraph 1 of Schedule 2A to the Insolvency Act 1986⁽⁴⁾;

“commodity” means any goods of a fungible nature that are capable of being delivered including metals and their ores and alloys, agricultural products, and energy such as electricity;

“conduit vehicle” of a ring-fenced body means an undertaking which satisfies the conditions set out in article 17(2) for the relevant financial institution described as D;

“correspondent banking” means an arrangement between two credit institutions pursuant to which one credit institution provides payment services to the clients of the other credit institution on behalf of that credit institution;

(1) “Ring-fenced body” is defined in section 142A of the Act.

(2) Directive 2011/61/EU, OJ L174, 1.7.2011, p1.

(3) 1986 c. 53.

(4) 1986 c.45. Schedule 2A was inserted by the Enterprise Act 2002 (c.40) s. 250(2) and Schedule 18. Paragraph 1 of that Schedule was amended by SI 2003/1468.

“covered bond vehicle” means a body corporate, partnership or unincorporated association—

- (a) which is a party to a capital market arrangement, or a transaction in pursuance of a capital market arrangement, and
- (b) whose business consists (apart from incidental activities) only of—
 - (i) providing guarantees, and
 - (ii) acquiring, owning and managing assets directly or indirectly forming the whole or part of the security for a capital market arrangement;

“credit institution” has the meaning given in Article 4.1(1) of the prudential requirements regulation;

“credit institutions directive” means the Directive of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending [Directive 2002/87/EC](#) and repealing Directives [2006/48/EC](#) and [2006/49/EC](#)([5](#));

“credit union” means a credit union as defined by section 31 of the Credit Unions Act 1979([6](#)) or a credit union as defined by Article 2(2) of the Credit Unions (Northern Ireland) Order 1985([7](#));

“debentures” include any investment of the kind specified by article 77 of the Regulated Activities Order 2001([8](#));

“default risk”, in relation to a ring-fenced body, means the risk that—

- (a) one or more persons will default under a transaction with a ring-fenced body or with a subsidiary undertaking of the ring-fenced body or will become unlikely, unwilling or unable to pay or repay sums owing at law or in equity to the ring-fenced body or to a subsidiary undertaking of the ring-fenced body,
- (b) an obligation to pay or repay sums owing at law or in equity to the ring-fenced body or to a subsidiary undertaking of the ring-fenced body will be restructured so as to reduce or postpone the payments due as principal, interest or fees resulting in a loss to the ring-fenced body or to its subsidiary undertaking, or
- (c) the value of any security or collateral taken by the ring-fenced body or a subsidiary undertaking of the ring-fenced body in connection with one or more transactions entered into by the ring-fenced body or its subsidiary undertaking will be insufficient to meet the obligations of the counterparty to the transaction when the security is enforced or the collateral is sold;

and for the purposes of paragraph (b), “restructuring” includes restructuring through a voluntary arrangement made with creditors, by court order or through the exercise of powers under the Banking Act 2009 or in equivalent legislation in other countries)

“derivative instrument” includes any of the instruments listed in paragraphs (4) to (10) of Section C of Annex 1 to the markets in financial instruments directive;

“exposure” means—

- (a) an asset referred to in Part Three, Title II, Chapter 2 of the prudential requirements regulation, or
- (b) an off-balance sheet item listed in Annex I to the prudential requirements regulation([9](#)),

(5) Directive 2013/36/EU, OJ L 174 27.6.2013, p338.

(6) [1979 c. 34](#). Section 31 has been amended by the Co-operative and Community Benefit Societies and Credit Unions Act 2010 (c.7), section 2.

(7) [S.I. 1985/1205 \(N.I. 12\)](#).

(8) [SI 2001/544](#). Article 77 was amended by [S.I. 2010/86](#); [2011/133](#).

(9) OJ L 176, 27.6.2013, p1.

without applying the risk weights or degrees of risk set out in the prudential requirements regulation;

“financial holding company” means a financial institution which is not a mixed financial holding company, the subsidiary undertakings of which are either exclusively or mainly credit institutions, investment firms or financial institutions and which has at least one subsidiary undertaking which is a credit institution or investment firm, and for the purposes of this definition, a financial institution is an undertaking other than a credit institution, the principal activity of which is to acquire holdings or to pursue one or more of the activities listed in points 2 to 12 and 15 of Annex I to the credit institutions directive;

“financial institution exposure” means an exposure to a relevant financial institution or an exposure to securities or other financial instruments issued by a relevant financial institution, but does not include an exposure where the sole or main purpose for which the ring-fenced body incurs the exposure to the relevant financial institution is to provide for—

- (a) the safeguarding and administration of assets of the ring-fenced body by that financial institution, or
- (b) client money or client assets to be held for the ring-fenced body by that relevant financial institution;

“global systemically important insurer” means an insurance undertaking, third country insurance undertaking, reinsurance undertaking or third country reinsurance undertaking which is included on the list of global systemically important insurers published by the Financial Stability Board on 18 July 2013, or on any updated version of that list or supplementary list of such undertakings published by the Financial Stability Board;

“instruments giving an entitlement to shares or debentures” includes any instrument of the kind specified by article 79 (instruments giving entitlements to investments) of the Regulated Activities Order 2001(10) which relates to shares or, as the case may be, debentures;

“insurance undertaking” has the meaning given in Article 13.1 of the solvency II directive(11);

“interest rate swap” has the meaning given in article 10(2)(c);

“liquid assets” means assets which qualify towards the liquidity coverage requirement provided for in Article 412 of the prudential requirements regulation as further specified in delegated acts adopted by the European Commission under Article 460 of that regulation;

“liquidity risk” means the risk that the ring-fenced body does not have, or is unable to obtain, sufficient financial resources to enable it to meet its financial obligations as they fall due;

“management company” has the meaning given in Article 2.1(b) of the UCITS directive(12);

“mixed financial holding company” means an undertaking which is not a credit institution, an insurance undertaking or an investment firm, which has at least one subsidiary undertaking which is a credit institution, an insurance undertaking or an investment firm and which, together with its subsidiary undertakings, constitutes a financial conglomerate (within the meaning given by Article 2.14 of Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002(13) on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (disregarding any decision taken under Article 3(3) of that directive);

“own funds” means own funds as defined in Article 4.1(118) of the prudential requirements regulation;

“payment exposures” means—

(10) Article 79 of the Regulated Activities Order 2001 was amended by [S.I. 2010/86](#).

(11) OJ L 335, 17.12.2009, p1.

(12) OJ L 302, 17.11.2009, p32. “UCITS directive” is defined in paragraph 4B of Schedule 3 to the Act.

(13) OJ L 35, 11.02.2003, p1.

- (a) in the case of foreign exchange transactions, exposures incurred in the ordinary course of settlement;
- (b) in the case of transactions for the purchase or sale of securities, exposures incurred in the ordinary course of settlement;
- (c) exposures arising from the provision of money transmission including—
 - (i) the execution of payment services,
 - (ii) clearing and settlement in any currency, and
 - (iii) correspondent banking; and
- (d) exposures incurred by the ring-fenced body to satisfy a condition required for participation by it in an inter-bank payment system (as defined in section 182 of the Banking Act 2009)(**14**) or in the services provided by a recognised clearing house(**15**), an EEA central counterparty(**16**) or a third country central counterparty(**17**) provided that such exposures are only to a relevant financial institution which is also a member or operator of the inter-bank payment system or a member of the relevant recognised clearing house, EEA central counterparty or third country central counterparty;

“payment services” has the same meaning as in regulation 2(1) of the Payment Services Regulations 2009(**18**);

“prudential requirements regulation” means the Regulation of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms(**19**);

“Regulated Activities Order 2001” means the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001(**20**);

“reinsurance undertaking” has the meaning given in article 13(4) of the solvency II directive;

“relevant financial institution” has the meaning given in article 2;

“securitisation undertaking” has the meaning given in article 3(1)(a);

“securities” means, any investments of the kind specified by any of articles 76 to 82 of the Regulated Activities Order 2001(**21**), or so far as relevant to any such investment, article 89 of that Order(**22**);

“security interest” means any legal or equitable interest created or otherwise arising by way of security including—

- (a) a pledge,
- (b) a mortgage,
- (c) a fixed charge,
- (d) a floating charge,
- (e) a lien;

“sell”, in relation to any investment, includes disposing of the investment for valuable consideration, and for these purposes “disposing of” includes—

(14) 2009 c.1.

(15) Defined in section 285(1)(b) of the Act. Paragraphs (b) to (d) of section 285(1) were substituted for the original paragraphs by S.I. 2013/504.

(16) Defined in section 285(1)(c) of the Act.

(17) Defined in section 285(1)(d) of the Act.

(18) S.I. 2009/209. There are amendments to regulation 2(1), but none are relevant to this Order.

(19) Regulation (EU) No 575/2013/EU, OJ L 176, 27.6.2013, p1.

(20) S.I. 2001/544.

(21) These articles were amended by S.I 2006/1969; 2010/86; 2011/133; 2011/2687, and article 77A was inserted by S.I. 2010/86.

(22) Article 89 was amended by S.I. 2006/2383.

- (a) in the case of an investment consisting of rights under a contract—
 - (i) surrendering, assigning or converting those rights, or
 - (ii) assuming the corresponding liabilities under the contract,
- (b) in the case of an investment consisting of other arrangements, assuming the corresponding liabilities under the arrangements,
- (c) in the case of any other investment, issuing or creating the investment or granting the rights or interests of which it consists;

“shares” include any investment of the kind specified by article 76 of the Regulated Activities Order 2001;

“solvency II directive” means the Directive of the European Parliament and Council of 25 November 2009 on the taking up and pursuit of the business of Insurance and Reinsurance⁽²³⁾;

“sponsored structured finance vehicle” means a structured finance vehicle which satisfies the conditions in article 3(2);

“structured finance vehicle” means a securitisation undertaking or a covered bond vehicle;

“third country insurance undertaking” has the meaning given in Article 13(3) of the solvency II directive;

“third country reinsurance undertaking” has the meaning given in Article 13(6) of the solvency II directive;

“title transfer collateral arrangement” means an agreement or arrangement, including a repurchase agreement, evidenced in writing, where—

- (a) the collateral provider transfers legal and beneficial ownership in the collateral to a collateral-taker on terms that when the relevant financial obligations are discharged the collateral-taker must transfer legal and beneficial ownership of the collateral (or equivalent collateral) to the collateral provider, and
- (b) the purpose of the agreement or arrangement is to secure or otherwise cover the relevant financial obligations owed to the collateral-taker;

“UCITS” has the meaning given in Article 1.2 of the UCITS directive;

“undertaking” includes a company, body corporate, partnership or unincorporated association.

Relevant financial institution

2.—(1) For the purposes of this Order, a “relevant financial institution” is an institution which falls within one of the classes listed in paragraph (2), and which is not within one of the exceptions set out in paragraph (3).

(2) The classes are—

- (a) credit institutions;
- (b) investment firms;
- (c) structured finance vehicles;
- (d) global systemically important insurers;
- (e) UCITS (wherever established) and alternative investment funds;
- (f) management companies or alternative investment fund managers; and
- (g) financial holding companies and mixed financial holding companies.

(3) The exceptions are—

(23) [Directive 2009/138/EC](#), OJ L 335, 17.12.2009, p1.

- (a) ring-fenced bodies;
- (b) building societies;
- (c) bodies corporate—
 - (i) whose purpose, or principal purpose, is that of making loans which are secured on residential property and which are funded substantially by their members, and
 - (ii) which are incorporated under the law of an EEA state other than the United Kingdom;
- (d) credit unions and other institutions referred to in Article 2.5 of the credit institutions directive (other than investment firms);
- (e) recognised clearing houses⁽²⁴⁾, EEA central counterparties⁽²⁵⁾ and third country central counterparties⁽²⁶⁾;
- (f) investment firms which are not authorised to carry on by way of business (in the United Kingdom or the EEA) the activities specified by either article 14 (dealing in investments as principal) or article 21 (dealing in investments as agent) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001⁽²⁷⁾;
- (g) a credit institution which is a UK institution or an EEA firm⁽²⁸⁾, and which—
 - (i) is not permitted to carry on any excluded activities (and for these purposes “excluded activities” do not include anything which does not fall within the definition of excluded activities in relation to a ring-fenced body by virtue of articles 4 to 12 of this Order) or
 - (ii) to do anything that a ring-fenced body is prohibited from doing under articles 14 to 20 of this Order,

by reason of requirements, limitations or other conditions imposed on the credit institution by the FCA or the PRA or (in the case of an EEA firm) by its home state regulator; or by EU law or the national law to which the credit institution is subject;
- (h) each of the institutions listed in the Schedule to this Order.

Securitisation companies and structured finance vehicles: definitions

3.—(1) In this Order—

- (a) “securitisation undertaking” means—
 - (i) an asset holding company,
 - (ii) a commercial paper funded company,
 - (iii) an intermediate borrowing company,
 - (iv) a note-issuing company, or
 - (v) a warehouse company; and
- (b) “asset holding company”, “commercial paper funded company”, “intermediate borrowing company”, “note-issuing company” and “warehouse company” means a company of the kind mentioned in paragraph (a), (b), (c), (d) or (e) of section 83(2) of the Finance Act

⁽²⁴⁾ Defined in section 285(1)(b) of the Act. Paragraphs (b) to (d) of section 285(1) were substituted for the original paragraphs by [S.I. 2013/504](#).

⁽²⁵⁾ Defined in section 285(1)(c) of the Act.

⁽²⁶⁾ Defined in section 285(1)(d) of the Act.

⁽²⁷⁾ [S.I. 2001/544](#). Article 14 was amended by [S.I. 2006/3384](#). Article 21 was amended by [S.I. 2003/1476](#); [2006/3384](#).

⁽²⁸⁾ Defined in paragraph 5 of Schedule 3 to the Act.

2005⁽²⁹⁾ or in paragraph (a), (b), (c), (d) or (e) of regulation 4(2) of the Taxation of Securitisation Companies Regulations 2006⁽³⁰⁾, except that for these purposes—

- (i) “company” includes any body corporate, partnership or unincorporated association, and
- (ii) the requirements in section 83(3)(b) of the Finance Act 2005 and regulation 5(3) of the Taxation of Securitisation Companies Regulations 2006 shall not apply.

(2) For the purposes of this Order, a structured finance vehicle is a sponsored structured finance vehicle of a ring-fenced body where the only assets held by the structured finance vehicle consist of any of—

- (a) money provided by the ring-fenced body or a subsidiary of the ring-fenced body;
- (b) assets, or an interest in assets, created by, or otherwise originated by, or comprising claims against, any one or more of the following—
 - (i) the ring-fenced body,
 - (ii) a securitisation undertaking, provided that the only assets held by the securitisation undertaking are assets created or otherwise originated by the ring-fenced body or any of its subsidiary undertakings, and assets within sub-paragraphs (c) to (h) below, or
 - (iii) a subsidiary undertaking of the ring-fenced body, provided that the assets concerned are assets which the ring-fenced body itself could hold;
- (c) liquid assets, investments or facilities acquired by or made available to the structured finance vehicle to enable it to limit the extent to which its business may be adversely affected by any of the factors referred to in article 6(2);
- (d) sums lent by the structured finance vehicle in connection with a capital market arrangement;
- (e) rights arising under derivative instruments entered into with any person for the purpose of the protection of the structured finance vehicle against any difference between any rate, index or price and any other rate, index or price;
- (f) rights arising under contracts with the ring-fenced body or with any other person for the provision of services to the structured finance vehicle;
- (g) rights arising under a contract with another sponsored structured finance vehicle of the ring-fenced body;
- (h) sums derived from any of the assets referred to in sub-paragraphs (a) to (g) above, including rights in relation to any current account, payment account or deposit account to which such sums are credited or paid.

PART 2

EXCLUDED ACTIVITIES AND EXCEPTIONS

Excluded activities: dealing in investments as principal

4. The activity of dealing in investments as principal described in article 14 of the Regulated Activities Order 2001 is an excluded activity even where it is not a regulated activity by virtue of articles 15, 19 or 20 of that Order, except where it is carried on in accordance with any of articles 6 to 12 of this Order.

⁽²⁹⁾ 2005 c. 7. Section 83 has been amended by the Finance Act 2006 (c.25), s.101; the Finance 2007 (c.11), s. 59 and the Corporation Tax Act 2009 (c.4), schedule 1, Part 2, paragraphs 648, 662.

⁽³⁰⁾ S.I. 2006/3296.

Excluded activities: commodities trading

5.—(1) Dealing in commodities is an excluded activity, except where it is carried on in accordance with this article, or any of articles 6, 8, 9, 10, 11 and 12.

(2) A ring-fenced body may deal in commodities where the commodities in question are required for its own use or consumption or for use or consumption by a subsidiary undertaking of the ring-fenced body.

(3) A ring-fenced body may deal in commodities in order—

- (a) to take a security interest over those commodities or to realise a security interest held over those commodities (including by selling the commodities), or
- (b) to enter into a title transfer collateral arrangement in relation to commodities, or acquire and hold equivalent commodities in accordance with the arrangement or enforce that arrangement (including by selling the commodities which are subject to that arrangement).

(4) For the purposes of this article, “dealing” means buying or selling commodities as principal.

Excluded activities: general exceptions

6.—(1) A ring-fenced body does not carry on an excluded activity by entering into a transaction with another person (including a structured finance vehicle) if the sole or main purpose for which the ring-fenced body entered into the transaction, either by itself or in combination with other transactions, is that of limiting the extent to which—

- (a) the ring-fenced body,
- (b) any subsidiary undertaking of the ring-fenced body,
- (c) any sponsored structured finance vehicle of the ring-fenced body,
- (d) any conduit vehicle of the ring-fenced body, or
- (e) any combination of the undertakings referred to in sub-paragraphs (a), (b), (c) and (d),

will be adversely affected by any of the factors specified in paragraph (2).

(2) The factors specified in this paragraph are—

- (a) changes in interest rates, exchange rates or commodity prices;
- (b) changes in any index of retail prices or of residential or commercial property prices;
- (c) changes in any index of the price of shares;
- (d) default risk;
- (e) liquidity risk.

(3) A ring-fenced body does not carry on an excluded activity by—

- (a) buying, selling or subscribing for investments which are liquid assets for the purpose of managing its liquidity, or
- (b) buying or subscribing for investments to provide collateral in connection with a transaction falling within paragraph (1), or selling investments acquired for that purpose.

(4) A ring-fenced body does not carry on an excluded activity by—

- (a) acquiring shares, debentures or instruments giving an entitlement to shares or debentures from an issuer where—
 - (i) the shares, debentures or instruments concerned are issued by the issuer, and
 - (ii) the consideration for the acquisition is the release by the ring-fenced body or by a subsidiary undertaking of the ring-fenced body of part or all of a debt owed by the

issuer or by another undertaking within the same group as that issuer to the ring-fenced body or the subsidiary undertaking of the ring-fenced body;

- (b) dealing in—
 - (i) debentures or instruments giving an entitlement to shares or debentures issued by the ring-fenced body or by a subsidiary of the ring-fenced body, or
 - (ii) debentures issued by a parent undertaking⁽³¹⁾ of the ring-fenced body;
- (c) acquiring a debenture where—
 - (i) the debenture is acquired from the issuer, and
 - (ii) the debenture relates to any loan, credit, guarantee or other similar financial accommodation made by the ring-fenced body or a subsidiary undertaking of the ring-fenced body to the issuer or to an undertaking in the same group as the issuer;
- (d) acquiring shares in a company—
 - (i) which is, or following such acquisition becomes, a subsidiary undertaking of the ring-fenced body, or
 - (ii) in which the ring-fenced body has, or following the acquisition will have, a participating interest⁽³²⁾.

(5) A ring-fenced body does not carry on an excluded activity by selling shares, debentures or instruments giving an entitlement to shares or debentures acquired or held by the ring-fenced body in accordance with paragraph (4)(a), (b) or (d).

- (6) A ring-fenced body does not carry on an excluded activity by—
 - (a) taking or granting a security interest over investments, or realising a security interest held over investments (including selling the investment over which the security is held), or
 - (b) entering into a title transfer collateral arrangement in relation to investments, acquiring equivalent investments in accordance with the arrangement or enforcing the arrangement (including by selling the investments which are subject to that arrangement).

Excluded activities: securitisation and covered bonds

7.—(1) A ring-fenced body does not carry on an excluded activity by selling investments to or buying investments from a sponsored structured finance vehicle of the ring-fenced body, or from a conduit vehicle of the ring-fenced body.

(2) A ring-fenced body does not carry on an excluded activity by acquiring any instrument creating or acknowledging indebtedness issued by one or more of its sponsored structured finance vehicles.

Excluded activities: central bank exemption

- 8.—(1) A ring-fenced body does not carry on an excluded activity where—
 - (a) it enters into a transaction with a central bank, or with a wholly owned subsidiary of a central bank, in the course of carrying on the activity specified in article 14 (dealing in investments as principal) of the Regulated Activities Order 2001, or which would fall within that activity if the transaction took place in the United Kingdom; or
 - (b) it sells commodities to, or buys commodities from, a central bank, or a wholly owned subsidiary of a central bank.
- (2) For the purposes of this article—

⁽³¹⁾ Defined in section 420 of the Act. Section 420(1) was amended by [S.I. 2008/948](#).

⁽³²⁾ Defined in section 421A of the Act. Section 421A was inserted by [S.I. 2008/948](#).

- (a) an undertaking is to be regarded as wholly owned by a central bank at any time if at that time—
 - (i) it is an undertaking of which no person other than the central bank or a nominee of the central bank is a member, or
 - (ii) it is a wholly owned subsidiary of an undertaking within paragraph (i);
- (b) an undertaking (“A”) is a “subsidiary” of another undertaking (“B”) if B—
 - (i) holds a majority of the voting rights in A,
 - (ii) is a member of A and has the right to appoint or remove a majority of A’s directors, or
 - (iii) is a member of A, and controls alone, pursuant to an agreement with other members, a majority of the voting rights in A;
- (c) A is a subsidiary of B if it is a subsidiary of an undertaking that is itself a subsidiary of B.

Excluded activities: derivatives

9. A ring-fenced body does not carry on an excluded activity by entering into transactions with any one or more of its account holders if—

- (a) the transaction satisfies the requirements listed in article 10 or 11(1), (2), or (3), and
- (b) all the conditions set out in article 12 are satisfied.

Derivatives: forward contracts and swaps

10.—(1) The requirements listed in this article are that the transaction is—

- (a) a currency swap,
- (b) an interest rate swap, or
- (c) a forward contract relating to currencies or commodities, where the relevant contract specifies—
 - (i) the description and amount of the currency or commodity concerned;
 - (ii) the date when delivery will be made or when settlement will be made in cash; and
 - (iii) the exchange rate or commodity price which will apply.

(2) For the purposes of this article—

- (a) “currency swap” means a transaction under which—
 - (i) one person (“A”) agrees with another person (“B”) that A will at a specified date pay to B a specified amount in one specified currency, and B will pay A that amount in another specified currency, calculated by reference to a specified exchange rate, and
 - (ii) the amount concerned may consist of a specified principal amount and interest calculated at a specified fixed or floating rate;
- (b) “forward contract” means a contract for the sale of a commodity, currency or property of any description (including futures, whether or not traded on an exchange or trading venue) under which delivery is to be made at a future date and at a price agreed on when the contract is made;
- (c) “interest rate swap” means a transaction under which—
 - (i) one person (“A”) agrees with another person (“B”) that A is liable to pay to B an amount equal to interest calculated by reference to an interest rate on a specified notional sum over a specified period, and that B is liable to pay to A an amount equal to interest calculated by reference to a different interest rate on that notional sum, and

- (ii) the interest rates in question are either specified (in the case of a fixed interest rate), or determined in relation to a specified reference rate (in the case of a floating interest rate);
- (d) “reference rate” means a foreign exchange or interest rate which is offered on an inter-bank market, or which is set out in an index published by any person who is not one of the parties to the contract;
- (e) “specified” means specified in the transaction agreement.

Derivatives: options and swaptions

- 11.—(1) The requirements listed in this paragraph are that—
- (a) the transaction is an option exercisable by a customer (“X”) of the ring-fenced body requiring the ring-fenced body to buy or sell foreign currency or commodities, and
 - (b) the contract in which the option is granted specifies—
 - (i) the currency or commodity concerned;
 - (ii) the amount of currency or commodity which may be bought or sold under the option;
 - (iii) a single date on which the option may be exercised (which must be no later than 3 years from the date on which the contract is entered into); and
 - (iv) the exchange rate or commodity price which will apply to the transaction.
- (2) The requirements listed in this paragraph are that—
- (a) the transaction consists of a cap or floor (or both) under which—
 - (i) in respect of a cap, the ring-fenced body must pay X an amount equal to A minus B (provided that amount is a positive number), where “A” is the interest payable in relation to a specified notional amount at the interest rate prevailing during the specified calculation period (“the floating interest rate”), and “B” is the interest payable on that notional amount at the interest rate specified in the agreement (“the fixed interest rate”), or
 - (ii) in respect of a floor, X must pay the ring-fenced body an amount equal to C minus D (provided that amount is a positive number), where “C” is the interest payable in relation to a specified notional amount at the interest rate specified in the agreement (“the fixed interest rate”), and “D” is the interest payable in relation to that notional amount at the interest rate prevailing during the specified calculation period (“the floating interest rate”), and
 - (b) the agreement relating to the cap or floor specifies—
 - (i) the notional amounts and the fixed and floating interest rates referred to in subparagraph (a)(i) and (ii); and
 - (ii) the calculation period.
- (3) The requirements listed in this paragraph are that—
- (a) the transaction consists of an option for the customer to enter into an interest rate swap;
 - (b) the agreement granting the option specifies—
 - (i) a single date on which the option may be exercised (which must be no later than 5 years from the date on which the agreement is entered into);
 - (ii) the terms which will apply to the interest rate swap, including the interest rates to which the swap applies; and
 - (iii) the notional amount on which the swap payments are to be calculated.

Derivatives: general conditions

- 12.—(1) The conditions in this article are that—
- (a) the position risk requirement attributable—
 - (i) to all transactions entered into which meet the conditions in articles 9 to 11, and
 - (ii) to any investments traded by the ring-fenced body under article 6(1) for the purpose of hedging risks arising in relation to the transactions referred to in paragraph (i) (provided that those investments are hedged separately from any other investments entered into by the ring-fenced body under article 6(1)),
 is at all times less than 0.5% of the ring-fenced body’s own funds;
 - (b) the sum of the position risk requirements attributable to each individual transaction with an account holder under articles 9 to 11 is at all times less than 25% of the credit risk capital requirement of the ring-fenced body; and in calculating the sum of the position risk requirements, no position risk requirement may be set off against any other position risk requirement;
 - (c) the sum of the position risk requirements attributable to the transactions entered into by the ring-fenced body under article 11 is at all times less than 20% of the sum of the position risk requirements attributable to the transactions entered into by the ring-fenced body under articles 9 to 11;
 - (d) there is evidence available at the date on which the transaction is entered into to assess the fair value of the investment concerned in accordance with international financial reporting standard 13 (“IFRS 13”) on fair value measurement issued by the International Accounting Standards Board, as that reporting standard is amended from time to time, and that evidence would be considered to constitute a level 1 input within the meaning of paragraph 76 of IFRS 13, or a level 2 input within the meaning of paragraphs 81 and 82 of IFRS 13⁽³³⁾;
 - (e) at the time the transaction is entered into, the investments traded under article 10 or 11 fall within a class of derivatives that are traded on—
 - (i) a trading venue in the EEA, or
 - (ii) a third country trading venue which satisfies paragraph 1(d) of Article 28 of the Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation No 648/2012⁽³⁴⁾; and for these purposes, “third country trading venue” has the same meaning as in that Article.
- (2) For the purposes of this article—
- (a) the position risk requirement shall be calculated in accordance with Chapter 2 of Title IV of Part Three of the prudential requirements regulation as if the positions associated with those investments are all held in the trading book of the ring-fenced body,
 - (b) “credit risk capital requirement” means the own funds requirements set out in Article 92.3(a) of the prudential requirements regulation, excluding the risk-weighted exposure amounts determined in accordance with Title II of Part Three of that regulation for counterparty risk arising from positions which are not included in the trading book;
 - (c) “trading venue” has the meaning given in Article 4.1(24) of the Directive 2014/65/EU of 15 May 2014 of the European Parliament and of the Council on markets in

⁽³³⁾ A copy of this IFRS can be obtained from the International Accounting Standards Board, 30 Cannon Street, London, EC4M 6XH.

⁽³⁴⁾ OJ L 173, 12.6.2014, p84.

financial instruments repealing [Directive 2004/39/EC](#) of the European Parliament and of the Council (recast)(35);

- (d) “position risk requirement” means the capital requirements for position risk calculated in accordance with Chapter 2 of Title IV of Part Three of the prudential requirements regulation; and
- (e) “trading book” has the meaning given in Article 4.1(86) of the prudential requirements regulation.

PART 3

PROHIBITIONS AND EXCEPTIONS

Prohibitions: inter-bank payment systems

13.—(1) A ring-fenced body (“A”) is prohibited from entering into any transaction enabling it to use services provided through an inter-bank payment system unless—

- (a) A is a direct participant in the system, or
- (b) where A is not a direct participant in the system, at least one of the conditions set out in paragraph (2) is satisfied.

(2) The conditions set out in this paragraph are—

- (a) the intermediary through which A accesses the services provided by the inter-bank payment system is another ring-fenced body which—
 - (i) is a direct participant in that payment system, and
 - (ii) is a member of the same group as A;
- (b) A is not eligible to become a direct participant in the inter-bank payment system concerned under the rules governing that payment system;
- (c) should the intermediary through which A accesses the services of the inter-bank payment system concerned cease to be able to provide access to those services, A would be able to make the payments it proposes to make through that inter-bank payment system—
 - (i) through another intermediary, or
 - (ii) through another inter-bank payment system or by other means; or
- (d) the PRA has, following an application made by A in accordance with paragraph (3), granted permission in accordance with paragraph (4) for A to access the services provided by the inter-bank payment system in question through the intermediary proposed by A.

(3) An application by A for permission under paragraph (2)(d) must be made in such manner and accompanied by such information as the PRA may direct.

(4) The PRA may only grant permission under paragraph (2)(d)—

- (a) where it considers that the ring-fenced body needs to be able to access the services provided by the inter-bank payment system in question due to exceptional circumstances; and
- (b) after it has published a statement under paragraph (9).

(5) The PRA shall keep any permission granted under paragraph (2)(d) under review, and shall withdraw that permission if it considers that the exceptional circumstances in question no longer apply, after following the procedure set out in paragraphs (6) and (7).

(6) If the PRA proposes—

- (a) to refuse an application for permission under paragraph (2)(d), or
- (b) to withdraw a permission granted under paragraph (2)(d),

it must give the ring-fenced body a warning notice, stating why it considers that the exceptional circumstances do not apply (if sub-paragraph (a) applies), or no longer apply (if sub-paragraph (b) applies).

(7) If the PRA has decided, after consideration of any representations received in writing from the ring-fenced body in response to the warning notice—

- (a) to refuse an application for permission under paragraph (2)(d), or
- (b) to withdraw permission granted under paragraph (2)(d),

it must give the ring-fenced body a decision notice.

(8) If the PRA decides—

- (a) to refuse an application for permission under paragraph (2)(d), or
- (b) to withdraw permission granted under paragraph (2)(d),

the ring-fenced body may refer the matter to the Tribunal, and Part 9 of the Act applies to any proceedings before the Tribunal in relation to the matter.

(9) The PRA must, before 1st July 2019, publish a statement containing guidance on what is meant by “exceptional circumstances” for the purposes of granting a permission under paragraph (2)(d) in a way appearing to the PRA to be best calculated to bring it to the attention of the public.

(10) Part 26 of the Act applies to any notices given by the PRA under this article.

(11) In this article—

“direct participant” means an institution which is able to provide services for the purpose of enabling the transfer of funds using the inter-bank payment system as a result of an arrangement made between the institution and the operator of the payment system;

“inter-bank payment system” has the meaning given by section 182 of the Banking Act 2009⁽³⁶⁾, but does not include—

- (a) a payment system the operator of which is—
 - (i) a recognised clearing house within the meaning of section 285(1) of the Act⁽³⁷⁾, or
 - (ii) the operator of a relevant system approved by the Bank of England under regulation 5 of the Uncertificated Securities Regulations 2001⁽³⁸⁾;
- (b) arrangements made by A with another credit institution for correspondent banking;
- (c) arrangements made to facilitate the physical transfer of money between financial institutions, including the Note Circulation Scheme set up by the Bank of England.

Prohibitions: financial institution exposures

14.—(1) A ring-fenced body is prohibited from incurring a financial institution exposure unless at least one of the exemptions set out in paragraphs (2) to (6) or in articles 15 to 19 applies, and, for the avoidance of doubt, provided that one of these exemptions applies in relation to a particular exposure, it is irrelevant whether the conditions for any other exemption are satisfied by that exposure.

⁽³⁶⁾ 2009 c.1.

⁽³⁷⁾ Section 285 has been amended by the Financial Services Act 2012 (c.21), section 28 and S.I. 2013/504.

⁽³⁸⁾ S.I. 2001/3755. Regulation 5 was amended by S.I. 2013/632.

(2) A ring-fenced body may incur a financial institution exposure if the sole or main purpose of the transaction giving rise to the exposure (by itself or in combination with other transactions) is to limit the extent to which—

- (a) the ring-fenced body,
- (b) any subsidiary undertaking of the ring-fenced body,
- (c) any sponsored structured finance vehicle of the ring-fenced body,
- (d) any conduit vehicle of the ring-fenced body, or
- (e) any combination of the undertakings referred to in sub-paragraphs (a), (b), (c) and (d),

will be adversely affected by any of the factors specified in paragraph (3).

(3) The specified factors are—

- (a) changes in interest rates, exchange rates or commodity prices;
- (b) changes in any index of retail prices or of residential or commercial property prices;
- (c) changes in any index of the price of shares;
- (d) default risk.

(4) A ring-fenced body may incur a financial institution exposure where the relevant financial institution concerned is a member of the same group as the ring-fenced body, provided that—

- (a) the exposure concerned is not prohibited under rules made by the FCA or the PRA under the Act; and
- (b) the exposure arises as a result of—
 - (i) a commercial transaction conducted on arm's length terms, or
 - (ii) a holding of shares or other securities issued by a subsidiary undertaking of the ring-fenced body.

(5) A ring-fenced body may incur a financial institution exposure in the course of buying, selling or subscribing for investments for the purposes of a transaction falling within paragraph (2).

(6) A ring-fenced body may incur a financial institution exposure where—

- (a) the exposure concerned is a payment exposure, and
- (b) the ring-fenced body has complied with any rules made or requirements imposed by the FCA or the PRA under the Act in relation to payment exposures.

Financial institutions exposures: trade finance

15.—(1) A ring-fenced body may incur a financial institution exposure provided that both the following conditions are satisfied—

- (a) the purpose of the transaction giving rise to the exposure is—
 - (i) to provide finance or make a payment in connection with the supply of goods or services by or to a person or an undertaking which is not a relevant financial institution; or
 - (ii) to guarantee or otherwise provide an indemnity or security for the obligations of a customer of the ring-fenced body or a third party in connection with the supply of goods or services by or to a person or an undertaking which is not a relevant financial institution;
- (b) the ring-fenced body enters into an agreement to give effect to the transaction which specifies—
 - (i) the supplies of goods or services to which the transaction relates, and

(ii) the maximum payments which the ring-fenced body may be required to make under the agreement.

(2) For the purpose of paragraph (1)(b)(ii), the maximum payments payable under the agreement may be expressed—

- (a) as a defined sum, or
- (b) as a multiple of an average price of a commodity, where the average price is determined by reference to prices quoted on a specified index of prices for that commodity over a specified period, and for these purposes “specified” means specified in the agreement.

Financial institutions exposure: securitisation and covered bonds

16. A ring-fenced body may incur a financial institution exposure to any sponsored structured finance vehicle of that ring-fenced body.

Financial institution exposures: conduit lending

17.—(1) A ring-fenced body may incur a financial institution exposure to a relevant financial institution (“A”) where—

- (a) the only business of A (apart from incidental activities) is to acquire, hold and manage assets from or for an undertaking which is not a relevant financial institution (“B”); and
- (b) all or part of A’s assets are being used to form the whole or part of the security for a loan or any other finance provided to A by the ring-fenced body or by a conduit vehicle of the ring-fenced body for the benefit of B.

(2) A ring-fenced body (“C”) may incur a financial institution exposure to a relevant financial institution (“D”) where—

- (a) D was established by, or is operated for the benefit of, C; and
- (b) the only business of D (apart from incidental activities) is—
 - (i) to acquire, hold and manage assets from or for C, or
 - (ii) to make loans or provide other finance at the direction or on the advice of C using resources provided by C or raised in the financial markets to entities which are not relevant financial institutions, or to relevant financial institutions which satisfy the conditions in paragraph (1)(a) and (b).

Financial institution exposures: repo transactions

18. A ring-fenced body (“A”) may incur a financial institution exposure to a relevant financial institution (“B”) pursuant to an agreement with B—

- (a) for the transfer of its own assets to B on terms—
 - (i) imposing an obligation on A to buy those assets, or assets of the same description, from B at one or more subsequent times; or
 - (ii) imposing an obligation on B to transfer those assets, or assets of the same description, to A at one or more subsequent times;
- (b) for the transfer of liquid assets from B to A for the purpose of managing A’s liquidity risk on terms—
 - (i) imposing an obligation on B to buy those assets, or assets of the same description from A at one or more subsequent times; or
 - (ii) imposing an obligation on A to transfer those assets, or assets of the same description, to B at one or more subsequent times.

Financial institution exposures: ancillary exposures

19.—(1) Subject to any rules made by the FCA or the PRA under the Act, a ring-fenced body may incur a financial institution exposure where the exposure concerned—

- (a) arises in any of the circumstances set out in paragraphs (2) to (5), or
- (b) is permitted under paragraph (6).

(2) The exposure arises in consequence of the provision—

- (a) by the ring-fenced body of payment services to its customers in the United Kingdom or any other country;
- (b) by the ring-fenced body to the relevant financial institution of—
 - (i) operational services, including in particular information technology, human resources or payment services, or
 - (ii) services as a trustee or agent in connection with a syndicated loan to an undertaking which is not a relevant financial institution; or

(c) to the ring-fenced body of services from a relevant financial institution which are ancillary to or facilitate—

- (i) the divestment or acquisition by the ring-fenced body of one or more of its subsidiaries or other assets,
- (ii) the continuing operation of a business, entity or assets which have been acquired by the ring-fenced body,
- (iii) an issue of securities by the ring-fenced body, by a subsidiary undertaking of the ring-fenced body or by a sponsored structured finance vehicle,
- (iv) the participation by the ring-fenced body in a syndicated loan to an undertaking which is not a relevant financial institution.

(3) The exposure arises where—

- (a) the ring-fenced body is acting as distributor for a relevant financial institution in connection with the distribution of trade finance or other financial products or investments issued by or services provided by the relevant financial institution, or in respect of which that relevant financial institution is acting as distributor,
- (b) the relevant financial institution is acting as a distributor for the ring-fenced body in connection with the provision by the ring-fenced body of trade finance or other financial products or investments issued by or services provided by the ring-fenced body to or for the benefit of an entity which is not a relevant financial institution.

(4) The exposure arises in consequence of guarantees, warranties, indemnities or covenants given to the ring-fenced body by a relevant financial institution as part of a permitted acquisition or disposal—

- (a) by the ring-fenced body, or
- (b) by a subsidiary undertaking of the ring-fenced body,

and for the purposes of this paragraph “permitted” means that the acquisition or disposal is not prohibited under the Act, this Order, or any rules made by the FCA or the PRA under the Act.

(5) The exposure arises in consequence—

- (a) of a breach of a duty owed by the relevant financial institution to the ring-fenced body, or
- (b) of the appointment of the ring-fenced body as executor of the estate of any person or of services provided by the ring-fenced body in that capacity.

(6) A ring-fenced body may incur a financial institution exposure to a global systemically important insurer where the exposure concerned results from the purchase of insurance by the ring-

fenced body for the benefit of the business, directors, officers, employees or other staff of the ring-fenced body or of any subsidiary undertaking of the ring-fenced body.

Prohibitions: Non-EEA branches and subsidiaries

20.—(1) A ring-fenced body must not—

- (a) maintain or establish a branch in any country or territory which is not an EEA member state, or
- (b) subject to paragraph (2), have a participating interest in any undertaking which is incorporated in or formed under the law of a country or territory which is not an EEA member state (a “non-EEA undertaking”).

(2) A ring-fenced body may, subject to rules made by the PRA under the Act, have a participating interest in a non-EEA undertaking which is an ancillary services undertaking within the meaning of article 4.18 of the prudential requirements regulation, if that undertaking does not carry on any activities that would be regulated activities under the Act if carried on in the United Kingdom.

(3) For the purposes of this article—

- (a) “branch” means a place of business that forms a legally dependent part of the ring-fenced body and conducts directly all or some of the operations inherent in its business;
- (b) “participating interest” has the meaning given in section 421A of the Act⁽³⁹⁾.

Transitional provision

21. A ring-fenced body does not carry on an excluded activity or contravene a prohibition imposed by this Order by holding or selling any investments on or after 1st January 2019 provided that—

- (a) the investment in question was created or acquired by the ring-fenced body before 1st January 2019, and
- (b) the period remaining until the investment matures is less than two years at 1st January 2019.

Date

Name
Name
Two of the Lords Commissioners of Her
Majesty’s Treasury

(39) Section 421A was inserted into the Financial Services and Markets Act 2000 by S.I. 2008/948.