

FSMA Market Abuse Regime:

final Impact Assessment on the sunset clauses

June 2008



HM TREASURY

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FINAL IMPACT ASSESSMENT

Summary: Intervention & Options

Department /Agency: HM Treasury	Title: Impact Assessment of the extension of the sunset clauses in the FSMA Market Abuse regime for a limited period	
Stage: Implementation	Version: Final	Date: 3 June 2008
Related Publications: UK Implementation of the EU Market Abuse Directive (Directive 2003/6/EC) – a consultation document (June 2004).		

Available to view or download at:

<http://www.hm-treasury.gov.uk>

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

Sunset clauses in the UK's market abuse legislation are due to expire on 30 June 2008 unless new legislation is adopted which allows them to remain in force. These clauses contain provisions that are superequivalent to the EU's Market Abuse Directive. The Government has reviewed this area and thinks that the sunset clauses should be extended until 31 December 2009. This Impact Assessment provides further details of the costs and benefits of this measure.

What are the policy objectives and the intended effects?

The Government's intention is to ensure high standards of market integrity and confidence balanced against commitment to the principles of better regulation.

What policy options have been considered? Please justify any preferred option.

Option 1: Retaining the current UK superequivalent offences for a further limited period.
Option 2: Allowing the current superequivalent offences to lapse.
Option 3: Making the current UK superequivalent offences permanent.

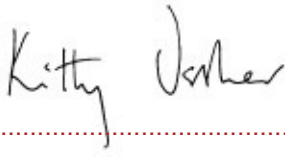
Option 1 is the Government's chosen option - to retain the current UK superequivalences for a further limited period until the outcome of the EU review is known. Extending the life of the sunset clauses will avoid unnecessary short-term changes to the regulatory framework and avoid possible pre-emptive UK legislation when change to the EU regime is expected.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? 2014.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible Minister:



..... Date: 05 June 2008

Summary: Analysis & Evidence

Policy Option: 1	Description: Retaining the current UK superequivalent offences for a further limited period.
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' Using the existing UK regime as the baseline, there would be no additional costs during 2008 as this option reflects the current situation.	
	One-off (Transition) Yrs		
	£ 10,600,000 1.5	There would be a cost of implementing the outcome of the EU review. We have used a variety of ranges and probabilities to arrive at this £10.6 million best estimate, reflecting the cost of between 2-8 hours work depending on the magnitude of the review and its similarity to existing UK requirements.	
	Average Annual Cost (excluding one-off)		
	£0		
Other key non-monetised costs by 'main affected groups'			

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups'. Using the existing UK regime as the baseline, there would be no additional benefits during 2008 as this option reflects the current situation.	
	One-off Yrs		
	£ 4,800,000 * 1.5	The benefits of moving towards to a harmonised regime on completion of the EU review would be £4.8m (as we are only considering a limited time frame this appears here as a one-off benefit). This benefit would arise from lower legal and compliance costs.	
	Average Annual Benefit (excluding one-off)		
	£0		
Other key non-monetised benefits by 'main affected groups'. We have not included any benefits of implementing the EU Review, as the benefits will be the same in each of the three options. Only the costs will change.			

Key Assumptions/Sensitivities/Risks

The annual costs of maintaining the superequivalences are not included as they are not additional to the status quo. The scale of the EU Review is as yet unclear – we have therefore had to estimate a wide range of possible costs of transitioning to that regime and the probability of the regime including something similar to parts of our current superequivalent regime. The benefits assume the EU review delivers a satisfactory outcome.

Price Base Year 2008	Time Period Years 1.5	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £ - 5,603,960
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What is the geographic coverage of the policy/option?		UK		
On what date will the policy be implemented?		Continuing		
Which organisation(s) will enforce the policy?		FSA		
What is the total annual cost of enforcement for these organisations?		£0		
Does enforcement comply with Hampton principles?		Yes		
Will implementation go beyond minimum EU requirements?		Yes		
What is the value of the proposed offsetting measure per year?		£ n/a		
What is the value of changes in greenhouse gas emissions?		£ n/a		
Will the proposal have a significant impact on competition?		No		
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	Yes/No	Yes/No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)	(Increase - Decrease)
Increase of £ Decrease £	Net Impact £

Key:

Annual costs and benefits: Constant Prices

(Net) Present Value

Summary: Analysis & Evidence

Policy Option: 2	Description: Allowing the sunset clauses to expire, thereby removing the superequivalences
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' This option involves two sets of transitional costs. Firstly, there would be a transitional cost of £4.8m estimated at two hours work in 2008 as firms adjusted their regimes to remove the superequivalences. Then, in 2009, there would be a further transitional cost of £13.35m estimated at between 3 and 8 hours work as firms changed their regimes depending on the outcome of the EU review.				
	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%; text-align: center;">One-off (Transition)</td> <td style="width: 30%; text-align: center;">Yrs</td> </tr> <tr> <td style="text-align: center;">£18,150,000</td> <td style="text-align: center;">1.5</td> </tr> </table>		One-off (Transition)	Yrs	£18,150,000	1.5
	One-off (Transition)		Yrs			
	£18,150,000		1.5			
	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%; text-align: center;">Average Annual Cost (excluding one-off)</td> <td style="width: 30%;"></td> </tr> <tr> <td style="text-align: center;">£0</td> <td></td> </tr> </table>		Average Annual Cost (excluding one-off)		£0	
Average Annual Cost (excluding one-off)						
£0						
Total Cost (PV)		£ 17,698,770				
Other key non-monetised costs by 'main affected groups' Removal of the superequivalences could lead to lower standards of market integrity and consequently market confidence which may lead to economic costs through higher costs of capital. These costs are harder to quantify and indeed are disputed. We have therefore not sought to quantify them but they could be material. In 2005 an estimate of the benefit of a robust market abuse regime was as high as £150 million, based on using spread (the difference between the best bid and offer prices in the market place) as a measure of liquidity. A calculation on the weighted average spread for FTSE 100 shares at a point on 16 June was 19 basis points. Based on total turnover in UK equities in 2003 of £1,540 billion, the spread cost was £2.9 billion. A one basis point increase in the spread using these figures would increase costs to the market of trading by £150 million.						

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' The benefit, or cost saving is calculated as £4.8m per year. This is the amount saved largely on legal costs. As we would be adjusting the regime mid 2008 the benefits this year would be halved. Spread over 1.5 years, this averages out to an annual benefit of £4.7 million a year.				
	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%; text-align: center;">One-off</td> <td style="width: 30%; text-align: center;">Yrs</td> </tr> <tr> <td style="text-align: center;">£</td> <td></td> </tr> </table>		One-off	Yrs	£	
	One-off		Yrs			
	£					
	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%; text-align: center;">Average Annual Benefit (excluding one-off)</td> <td style="width: 30%;"></td> </tr> <tr> <td style="text-align: center;">£ 4,691,840</td> <td style="text-align: center;">1.5</td> </tr> </table>		Average Annual Benefit (excluding one-off)		£ 4,691,840	1.5
Average Annual Benefit (excluding one-off)						
£ 4,691,840	1.5					
Total Benefit (PV)		£ 7,037,760				
Other key non-monetised benefits by 'main affected groups' The greater the degree of harmonisation in Europe in terms of market abuse rules, supervisory practice and enforcement, the closer we will be in creating a single European market for financial services.						

Key Assumptions/Sensitivities/Risks. Key assumptions are the time taken to implement changes resulting from EU review.

Price Base Year 2008	Time Period Years 1.5	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £ - 10,661,010
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What is the geographic coverage of the policy/option?		UK		
On what date will the policy be implemented?		30 June 2008		
Which organisation(s) will enforce the policy?		FSA		
What is the total annual cost of enforcement for these organisations?		£0		
Does enforcement comply with Hampton principles?		Yes		
Will implementation go beyond minimum EU requirements?		No		
What is the value of the proposed offsetting measure per year?		£ n/a		
What is the value of changes in greenhouse gas emissions?		£ n/a		
Will the proposal have a significant impact on competition?		No		
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	Yes/No	Yes/No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)		
Increase of	£	Decrease	£	Net Impact
				£

Key:

Annual costs and benefits: Constant Prices

(Net) Present Value

Summary: Analysis & Evidence

Policy Option: 3	Description: Making the current UK superequivalent offences permanent.
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COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' Using the existing UK regime as the baseline, there would be no additional costs during 2008 as this option reflects the current situation. There would be a cost of implementing the outcome of the EU review. We have used a variety of ranges and probabilities to arrive at this £10.6 million best estimate, reflecting the cost of between 2-8 hours work depending on the magnitude of the review and its similarity to existing UK requirements.
	One-off (Transition)	Yrs	
	£ 10,600,000	1.5	
	Average Annual Cost (excluding one-off)		
	£0		
Total Cost (PV)			£ 10,241,720
Other key non-monetised costs by 'main affected groups'			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' We have not included any benefits of implementing the EU Review, as the benefits will be the same in each of the three options. Only the costs will change.
	One-off	Yrs	
	£0		
	Average Annual Benefit (excluding one-off)		
	£0		
Total Benefit (PV)			£0
Other key non-monetised benefits by 'main affected groups'			

Key Assumptions/Sensitivities/Risks The scale of the EU review is as yet unclear – we have therefore had to estimate the possible costs of implementation.

Price Base Year 2008	Time Period Years 1.5	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £ - 10,241,720
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What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	Continuing
Which organisation(s) will enforce the policy?	FSA
What is the total annual cost of enforcement for these organisations?	£0

Does enforcement comply with Hampton principles?		Yes		
Will implementation go beyond minimum EU requirements?		Yes		
What is the value of the proposed offsetting measure per year?		£ n/a		
What is the value of changes in greenhouse gas emissions?		£ n/a		
Will the proposal have a significant impact on competition?		No		
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	Yes/No	Yes/No	N/A	N/A
Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)		
Increase of £	Decrease £	Net Impact	£	

Key:

Annual costs and benefits: Constant Prices

(Net) Present Value

EVIDENCE BASE: FOR SUMMARY SHEETS

Background

1.1 The purpose of this assessment is to review sections 118(4) and 118(8) contained in Part 8 of Financial Services and Markets Act 2000 (FSMA). These are legislative provisions, which prohibit a wider range of behaviours than the Market Abuse Directive. The aforementioned provisions are subject to a three-year sunset clause, which means that they will automatically lapse on 30th June 2008 unless new legislation is adopted to allow them to remain in force.

1.2 The objective of the Review is to establish whether the expected benefits of having all or part of these superequivalent provisions has exceeded the cost. The Review should take into account the enforcement of the regime, market understanding, costs & competitive impact and foreign rules and implementation.

1.3 The EU Market Abuse Directive was implemented in the UK on 1 July 2005 through the Financial Services and Markets Act 2000 (Market Abuse) Regulations 2005 and through changes in the FSA's rules. The aim of the Directive is to achieve greater confidence in the integrity of the financial markets in the EU by introducing a common administrative framework for deterring and punishing market abuse, and through providing a proper flow of information to the market. The Directive covers insider dealing, market manipulation and a framework for proper disclosure to the market. MAD is one of the key directives implemented as part of the Financial Services Action Plan (FSAP) that seeks to deliver an effective single market in financial services in the European Union.

1.4 During the consultations on implementing MAD there were mixed views as to the benefits of maintaining the superequivalent provisions. Those in favour of keeping the superequivalent provisions felt that the boundaries of the regime were familiar and were relevant in providing the UK with a more secure trading environment. Others argued that the UK should only prohibit behaviours defined by the Directive, as this was sufficient.

1.5 Given the range of views on which approach the UK should be taking, it was decided to maintain the original UK definitions of market abuse for a limited period. The underlying rationale for this was to gather more evidence and allow time to conduct a comprehensive review of these provisions.¹ The sunset clauses were inserted into the legislation so that the provisions would expire unless new legislation was introduced.

1.6 This policy and impact assessment is informed by dialogue between HM Treasury, FSA, relevant trade associations and industry.

Legislative proposals and options

1.7 The first option is to retain the current UK regime for a further limited period until the outcome of the EU review is known. The Commission are themselves reviewing the MAD in 2008 and we will take this opportunity to work for an outcome that delivers a satisfactory EU regime and to promote wider discussion of some of the

¹ For further information on the rationale behind our policy please refer to the February 2005 HMT feedback statement http://www.hm-treasury.gov.uk/media/C/E/MAD_feedback240205.pdf

elements of our superequivalences. Indeed one element of the superequivalences is already on the EU radar for possible changes to the MAD.

1.8 The European Commission are likely to be influenced by the European Securities Markets Experts group (ESME) report that identified practical difficulties that arise from having the same definition for market abuse and the disclosure obligation. In particular they think that the current requirements result in issuers having to disclose information too early and it would be preferable if the dates at which information becomes 'abusable' or 'disclosable' were separated. The UK already has such a distinction because of the superequivalences. The changes to MAD could result in new regulations from Europe that more closely resemble our rules.

1.9 Whatever the outcome of the EU review, allowing the superequivalent provisions to lapse in June 2008 and then implementing the EU's changes will subject the industry and FSA to two sets of changes in short succession. This would have cost implications and also a potentially negative impact on market understanding.

1.10 The second option is to align the UK regime with the EU Market Abuse Directive requirements now. Removing the superequivalences would simply require us to let the sunset clauses expire, as they would do as a matter of course, on 30 June 2008. No new legislation would be required. This will deliver some efficiency savings for financial firms and help maintain UK competitiveness by aligning our regime with that of our European counterparts. However, as noted above, it is possible that some legislation would have to be re-introduced following the outcome of the EU review and some of the superequivalent provisions would be re-established.

1.11 The third option is to make the superequivalences permanent. This would provide reassurance to the investing community that the widest range possible of market abuse offences were captured by the UK legislative framework but we would in any event have to consider possible changes arising from the EU's review.

BENEFITS

Option 1

1.12 Retaining the super-equivalent provisions for a limited period could maintain high standards of market integrity and consequently market confidence. These benefits are ongoing and hence not new. It would also allow wider discussion of the benefits of the superequivalences. Closer harmonisation with the revised EU regime would bring the benefits of European harmonisation, simplification for those firms operating on a pan-European basis and lower compliance costs.

1.13 The costs of the superequivalences were estimated at around £ 3 million in 2004 or an average of around 2 hours per firm. This cost has been updated to around £5 million. This reflects an increase in the number of firms and of staff costs. When the market abuse regime was introduced in 1999 it was estimated that there was a cost of £500 an hour for firms in seeking advice on the regime (made up of internal costs and the costs of external legal advice). In our 2004 consultation, we updated this to £610 an hour on the basis of increases in average earnings of those working on financial intermediation. We update this cost again to £690 per hour, stressing that this is the result of the combined cost of internal project work and the cost of seeking internal and external legal advice.

Option 2

1.14 The main benefits associated with immediately removing the superequivalences would be the earlier harmonisation of our rules with MAD. A greater degree of harmonisation would be beneficial for a variety of reasons. For example, it would remove complexities for those firms operating on a pan-European basis. This is likely to mean lower compliance costs for firms (through alignment of training and control processes and reduced numbers of suspicious transaction reports). These cost savings are not likely to be large. There are also likely to be lower ongoing legal costs for firms. As discussed above, these were estimated as around £3 million in 2004 and we have updated this to savings of £4.8million in 2009 with a saving of £2.4 million during 2008, as the new regime would start midway through the year.

1.15 There is no evidence to suggest that any welfare-creating business might be possible if the superequivalent provisions were allowed to lapse and so there are probably no benefits in terms of business creation from this option.

Option 3

1.16 Making the superequivalences permanent could lead to higher standards of market integrity and consequently market confidence, which may lead to economic benefits through lower costs of capital. These benefits, to the extent that they arise, would be ongoing and hence are not additional.

1.17 Whether benefits arise in practice depends on whether the superequivalent provisions actually deter abuse. In turn, deterrence will depend on the expectation of market participants that the provisions will result in successful enforcement. Since the implementation of MAD in 2005 no action based on the superequivalent provisions has been taken, suggesting at first glance no additional incremental benefits. However, if there is increased enforcement of these superequivalent provisions in the future there should be incremental economic benefits.

COSTS

Option 1

1.18 The costs of temporarily retaining the superequivalences are the additional legal costs and compliance costs resulting from the more complex UK regime, as against a regime aligned with the Directive. These costs would be ongoing and are not new. The cost of implementing the EU review is estimated at £10.6 million. We have used a variety of ranges and probabilities to arrive at this £10.6 million best estimate, reflecting the cost of between 2-8 hours work depending on the magnitude of the review and its similarity to existing UK requirements.

Option 2

1.19 Removing the superequivalences will involve costs. The one-off costs of adjustment will vary from firm to firm but we have estimated an average two hours at a consolidated cost of £690 an hour. This means a one-off cost of £4.8 million to remove the sunset clauses. The costs to the industry would largely be related to changing training programmes as well as adjusting procedures and manuals.

1.20 Removing the superequivalences would also entail costs to the FSA arising from changes to the handbook training materials and some retraining of staff. There may also

be additional queries to the FSA arising from change to the regime. These costs are not believed to be significant.

1.21 There is potential for costs to arise to the extent that removal of the super-equivalent provisions leads to lower market confidence and to the extent that this manifests itself in a higher cost of capital for firms.

1.22 There would be further costs under this option resulting from implementing the European review of MAD. This cost will depend on the amount of changes to the regime. Therefore under this option firms would bear the costs of changing their processes now and further costs in the future if the Directive requirements are further altered. Firms may of course opt not to update their internal systems pending the outcome of the EU review. This could lead to considerable confusion in the market. We have assumed that firms would remove the superequivalences given the uncertainty about the precise timing and outcome of the EU review.

Option 3

1.23 The costs of permanently retaining the superequivalences are the additional legal costs and compliance costs resulting from the more complex UK regime, as against a regime aligned with the Directive. These costs would be ongoing and are not new. Firms would also face the costs of implementing the outcome of the European Commission's review.

COMPETITION ASSESSMENT

1.24 There is no evidence to suggest that any of these proposals has an impact on competition.

SMALL FIRMS IMPACT TEST

1.25 All firms authorised to conduct investment management and securities business in the UK currently have to work within the market abuse regime. Removing the superequivalences may impose additional burdens on smaller firms as they may be less well placed to cope with two sets of regulatory change in short order.

Specific Impact Tests: Checklist

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

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