Delivering market confidence

Introduction

One of the FSA's statutory objectives was to maintain confidence in the UK's financial system. The *2012/13 Business Plan* highlighted that the aim was to deliver efficient, clean, orderly and fair markets that remain attractive and sustainable, both in the UK and internationally.

High quality, transparent and open markets remain vital for the UK's position as a leading international financial centre.

This chapter sets out how the FSA delivered on the *2012/13 Business Plan* aims, set out as:

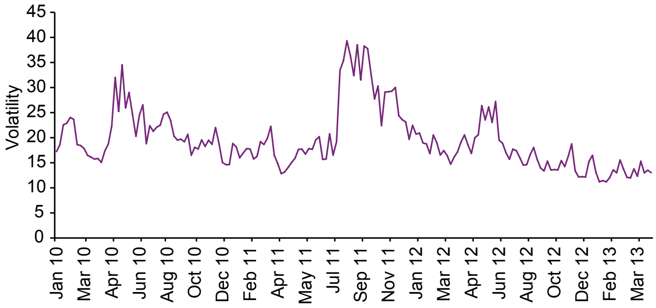
- Supervisory initiatives including market surveillance and market abuse and transaction reporting.
- Domestic policy initiatives, including work on listing rules, regulated covered bonds and client asset work (CASS).
- International policy initiatives, including Markets in Financial Instruments Directive (MiFID) and European Market Infrastructure Regulation (EMIR).

The FSA's work in response to the London Inter-Bank Offered Rate (LIBOR) also formed an important part of its work on market confidence in 2012/13.

Key metrics

The FSA used a number of key metrics to measure its success against its market confidence objective, including:

Chart 1: Market volatility

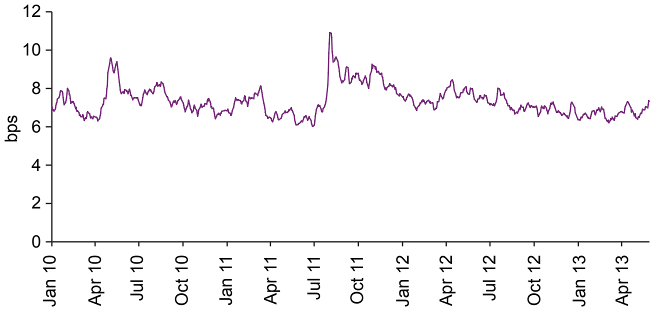


Source: LiquidMetrix

Equity market volatility fell to 13% by end March 2013, from 16% in December, despite continued weakness in the UK's economic outlook and on-going political uncertainty in Italy and recent events in Cyprus highlighting that issues in the Euro area periphery remain unresolved.

While central bank intervention in part triggered a broad rally in financial markets, the returns on UK equities were unimpressive internationally when adjusting for inflation (and dollar terms). The low returns are reflective of the UK's weak economic prospects and are likely to discourage capital investment in the UK inhibiting future growth. The VFTSE is the market's expectation of 30-day share volatility expressed through FTSE 100 options prices. The higher the figure, the more volatile the stocks. A VFTSE index below 20 has historically been associated with periods of market stability.

Chart 2: Bid-offer spread



Source: LiquidMetrix

The spread is determined by the difference in the buy and sell price for FTSE 100 stocks. Generally, a smaller bid-offer spread indicates more efficient pricing and greater liquidity of the FTSE 100. The average bid-offer stabilised towards 7 basis points throughout 2012 and into 2013, in line with the general improvement in global financial markets.

Supervisory initiatives

Market cleanliness

As part of its market monitoring activity, the FSA analysed the scale of share price movements in the two days ahead of regulatory takeover announcements and identified movements that are abnormal compared to a stock's normal movement. The FSA published the statistics annually and going forward the FCA remains the only regulator that regularly publishes market cleanliness statistics.

However, it is important to note that the level of such abnormal pre-announcement price movements (APPMs) does not provide a precise measure of the level of suspected insider dealing.

Many factors, other than insider trading, could cause an abnormal price movement ahead of a takeover announcement; for example, financial analysts or the media correctly assessing which companies are likely takeover targets or non-abusive trades that just happen to fall before an announcement. It is not possible to determine which of these factors are behind each abnormal price movement and therefore whether any insider dealing might have taken place.

After remaining stable for the four years to 2009, the level of APPMs declined to 21.2% in 2010, 19.8% in 2011 and to 14.9% in 2012. This is the lowest level since 2003. The fall took place in a year of weak takeover activity and against a backdrop of the FSA's continuing focus on market abuse and enforcement activity in this area.

LIBOR and the Wheatley Review

Following a lengthy investigation the FSA concluded its case against Barclays for misconduct in relation to LIBOR. Shortly after publishing the FSA's findings, the UK Government commissioned Martin Wheatley to conduct an independent review of the production of the LIBOR in July 2012. The FSA provided support to the Review.

Following publication of the Wheatley Review the FSA worked to implement a regulatory regime for benchmarks, which initially will only extend to LIBOR. Under this regime, the FCA will directly supervise contributing banks' processes and control frameworks for submitting to LIBOR. The regime also requires the firms that administer LIBOR to have effective governance arrangements, as well as procedures for the monitoring and surveillance of submissions.

The regulatory regime for LIBOR came into effect on 2 April 2013.

Record fines for LIBOR misconduct

This year the FSA took enforcement action against three firms for misconduct relating to LIBOR and other benchmarks.

Barclays Bank plc. was fined £59.5m in June 2012, UBS AG was fined £160m in December 2012 and RBS plc. was fined £87.5m in February 2013. These are the largest penalties the FSA imposed. They breached Principle 5 of the Principles for Businesses by failing to observe proper standards of market conduct by making inappropriate submissions, as well as Principle 3 by failing to have adequate systems and controls around their submission setting processes. Barclays also breached Principle 2 by failing to conduct its business with due skill, care and diligence when considering issues raised internally in relation to its LIBOR submissions. The cases highlighted a range of misconduct. This differed from bank to bank, but included:

- making submissions that took into account requests made by derivatives traders at both the bank and other banks;
- taking into account the impact of LIBOR on the profitability of transactions in money market trading books when making such submissions;
- colluding with inter-dealer brokers and other banks in seeking to influence other banks' JPY LIBOR submissions, including making corrupt payments to reward brokers for their efforts;
- 'lowballing' submissions to avoid negative media comment;
- combining the responsibility for making LIBOR and EURIBOR submissions with that of derivative trading and other failures to manage the inherent conflicts of interest arising from benchmark setting and trading in instruments related to those benchmarks;
- the compliance function failing to respond appropriately to internal concerns raised regarding LIBOR submissions; and
- providing an attestation to the FSA about the adequacy of its LIBOR submissions-related systems and controls, even though at that time they were inadequate.

Investigations into benchmark-related misconduct continue under the new regulatory regime.

Approved Persons changes

A key recommendation of the Wheatley Review of LIBOR was specifying LIBOR activities as regulated activities, bringing LIBOR activities within the scope of statutory regulation. In December 2012 the FSA published its proposals for the regulation and supervision of benchmarks such as LIBOR. As of 1 April 2013, providing information to, and the administering of, specified benchmarks became regulated activities under FSMA.

As part of these proposals, to assist the enhanced accountability and ensure compliance with its rules, the FSA extended the Approved Persons regime to create two new Significant Influence controlled Functions: one for the oversight of submission processes within panel banks and one to oversee the governance arrangements at benchmark administrators. As a result those individuals in management roles in relation to the new LIBOR-regulated activities will have to become FCA approved persons.

Supervising Multilateral Trading Facility (MTF) operators

In 2012/13 the FSA began centralising its supervision of around 50 MTF operators alongside other trading venues to ensure that it supervised them to a consistent standard to the regulated markets they compete with, taking into account their markets. The FSA engaged with MTF operators to understand their business models and the specifics of the markets in which they operate to inform the design of a supervisory framework. The framework is designed to ensure that where an MTF has a significant market impact, or impact on the FCA's statutory objectives, it will have a closer supervisory relationship with the FCA. Further, it will incorporate a peer group approach based on asset class to seek a level playing field within individual markets to facilitate competition. The FSA concluded the design phase of the framework and wrote to all UK MTF operators in March 2013 to inform them of the future approach.

Market abuse and insider dealing

The FSA had a successful year that has seen the culmination of many years' work in several criminal and non-criminal investigations. It continued to take civil and criminal action to support its credible deterrence agenda and keep markets clear and fair. It also published a number of market abuse enforcement outcomes and saw the conclusions of a record number of insider dealing trials this year.

More convictions and longer sentences

Over the last 12 months the FSA conducted four criminal trials, prosecuting more individuals for insider dealing this year than any other. This included James Sanders and Richard Joseph, who both received four year sentences in separate cases for insider dealing, which are the highest sentences imposed in FSA insider dealing cases to date.

Increasing complexity of cases

Cases are increasing in complexity, and this year the FSA successfully prosecuted its most complex case, Operation Saturn, securing the convictions of an insider dealing ring trading multiple stocks between 2006 and 2008.

Increase in guilty pleas

In 2012/13 the FSA saw an increase in the number of defendants charged with insider dealing who pled guilty, with five individuals pleading guilty in the period. One of these, Thomas Ammann, was sentenced to two years and eight months' imprisonment for two counts of insider dealing and two counts of encouraging insider dealing. Mr. Ammann had used inside information to encourage two others to deal. The FSA's most recent plea was from Paul Milsom, a senior equities trader, who was sentenced to two years' imprisonment for disclosing inside information between 2008 and 2010.

Increase in convictions of approved persons

This year saw increasing numbers of FSA approved persons being convicted. This is as a result of targeting individuals within the industry in market abuse investigations. Examples of approved persons convicted this year are James Sanders and James Swallow, who were sentenced to four years and ten months in custody respectively after pleading guilty to insider dealing. Both Sanders and Swallow had been FSA-authorised directors at Blue Index, a specialist Contract for Difference (CFD) brokerage.

Recovery of proceeds

Proceedings are on-going to recover the proceeds of crime from those prosecuted in the last year, but the FSA has secured over £2.4m since 2009.

Non-criminal outcomes

Where criminal prosecutions have not been appropriate the FSA also continued to bring non-criminal action for regulatory market abuse, including imposing fines of £1.58m on three individuals, and four prohibitions for market abuse and market manipulation. The Upper Tribunal also issued a judgement upholding an FSA decision to impose an £8m penalty on a company formerly known as Swift Trade Inc. for repeated market manipulation.

Operation Saturn

This was the longest and most complex prosecution brought by the FSA. Following a four and half month trial, six defendants were convicted of insider dealing in July 2012 and all received prison sentences ranging between 18 months and 3.5 years. The defendants, Ali Mustafa, Pardip Saini, Paresh Shah, Neten Shah, Bijal Shah and Truptesh Patel, obtained confidential and price sensitive information from investment banks concerning proposed or forthcoming takeover bids. They then used a large number of accounts to place spread bets before announcements knowing that when the information became public knowledge, the price would rise. The defendants were convicted of making a combined profit of £732,045 trading six stocks. Proceedings are ongoing to confiscate the defendants' proceeds. It was a sophisticated and complex scheme in which the defendants took careful steps to conceal activity such as the use of un-registered mobile phones and email drop-boxes.

To uncover and investigate the criminal actions, the FSA obtained and reviewed over 200,000 lines of trading in 130 accounts and 375,000 lines of telephone call records. Digital forensic technology played a critical part in establishing the passage of data between the defendants. Over 300 witness statements were adduced at the trial.

This case demonstrated the FSA's determination to tackle serious insider dealing and its capability to investigate complex rings and methods of committing this crime and to bring the perpetrators to justice.

Market surveillance

The FSA acquired software that enhanced its technological intelligence based detection of market risks and abuse. This work will enhance proactive detection of market abuse under the new regulatory regime.

The FSA also established the Investment Bank Surveillance Forum (IBSF) in Q3 2012. It invited the largest 12 investment banks by transaction reporting volumes in the UK to attend to discuss surveillance and market fragmentation as well as an opportunity for sharing best industry practice and encouraging competition. Both the IBSF and the Surveillance Practitioners Group, which continued throughout 2012/13, enjoyed a good attendance.

Transaction reporting

The FSA took action against two firms in the last year for transaction reporting failings – Plus500UK Ltd and James Sharp and Company.

During 2012/13 Plus500UK Ltd and James Sharp and Company were fined £205,128 and £49,000 respectively for failing to provide accurate and timely transaction reports to the FSA.

Between 29 June 2010 and 5 November 2011 Plus500, an online CFD trading facility provider, conducted 1,332,000 reportable transactions. The firm, however, failed to report any of these accurately and omitted entirely to report 189,000 transactions.

Between 5 November 2007 and 8 February 2011 James Sharp and Company, an independent stockbroking firm, failed to report any of the approximately 71,000 reportable transactions that it undertook.

Both firms' systems and controls were inadequate in that they did not have any documented procedures in place for transaction reporting and failed to provide any relevant training to staff. They therefore breached rules in SUP 17 of the FSA Handbook and Principle 3 of the FSA's Principles for Business.

James Sharp and Company were fined under the old penalties policy but Plus500 were the first regulated firm to be fined for transaction reporting failings under the new FSA penalties policy which came into force on 6 March 2010. This policy was established to provide a consistent and more transparent framework to calculate financial penalties. As a result the penalty imposed on Plus500, which was based on the number of affected transactions, was larger than it would have been under the previous regime.

These fines are a reminder that firms subject to the transaction reporting regime, regardless of size, should comply at all times with their obligations.

CASS

The *2012/13 Business Plan* set out the FSA's commitment to strengthen further its intensive regulatory and supervisory approach for firms holding client money and safe custody assets and increase its knowledge and oversight of the UK market.

The FSA made progress against these commitments by:

- Further increasing the specialist regulatory and supervisory resources dedicated to client asset protection in the FSA.
- Completing an additional 14 firm visits (51 vs. 37 visits) and an additional 13 desk based reviews (70 vs. 57 reviews) during 2012 compared to 2011.
- Fining two firms for breaches for failures in protecting their client assets. BlackRock Investment Management was fined £9,533,100 and Christchurch Investment Management was fined £26,600 for breaching FSA Principles and rules in relation to the adequate protection of client money.
- Publishing a total of nine papers to make specific enhancements to the CASS regime, in particular CASS 5 for General Insurance Intermediaries, improvements to the Client Money and Assets Return (CMAR) and reporting regimes, implementation of the CASS resolution pack and changes that will need to be implemented through EMIR.
- Actively engaging with International Organisation of Securities Commission (IOSCO) regarding the protection of client assets in going concerns and with FSB ResG for resolution of complex cross border failures.

Industry engagement

The FSA also made progress against its commitments through engagement with industry. It held a Client Assets & Markets Conference where messages relating to CASS failings were delivered and attended the Asset Management Conference to run CASS-specific workshops. It also worked more closely with the CF10a persons of all CASS Large firms.

There were still fundamental and significant failures in the ability of some firms to properly identify and segregate clients' money and assets, but the large attendance at both conferences and the specific interest shown in CASS were clear indicators that the FSA's messages had an effect and that the industry has heightened awareness of the standards required.

Risk methodology

The CASS Unit further developed the FSA's risk methodology using CMAR and Client Asset audit data. These data sources feed directly into its processes to prioritise workloads that align to its risk appetite. Under the new regulatory regime, all CMAR returns are monitored monthly and all annual audits are reviewed for content.

Special Administration Regime (SAR)

The CASS Unit continued to liaise with the Administrators of Lehman Brothers regarding potential returns to UK clients. The FSA also monitored those firms that were put into the SAR in late 2011 and early 2012 to monitor the effectiveness of this new process.

The FSA assisted the Government appointed independent reviewer of the SAR in assessing whether the SAR has met its objectives. The FSA shared its experiences from recent administrations as well as the feedback from its wider review of the client assets regime.

Review of CASS regime

In September 2012, the FSA published a consultation paper setting out a number of discrete proposals and discussion on the wider changes to its regime to achieve better results in the event of insolvency of a firm holding client money and custody assets (client assets). This paper stated that the objective of the review was:

- Improving the speed of return of client money and assets following a failure of a firm.
- Minimising the market impact of a failure of a firm that holds client money and assets.
- Achieving a greater client assets return for clients following a failure of a regulated firm.

The proposals to permit porting were made in December 2012 and came into effect in January 2013. This allows the supporting margin held at clearing houses to be ported alongside the client positions to which they relate in the event of failure of a clearing broker. This change, in line with European regulatory developments (namely EMIR), should, under the FCA, help reduce the market impact of an insolvency of clearing broker.

Wholesale conduct supervision

Development of supervisory approach

Wholesale conduct is the term used to describe how market participants interact with each other and conduct their business in wholesale markets (banking, insurance and securities) including trading or dealing on markets and the behaviours of regulated firms in their dealings with non-retail clients. It refers to the activities of participants in wholesale markets, not to a defined population of firms.

The new supervisory tools and processes that have been developed for conduct supervision generally are as relevant and applicable to work in relation to wholesale as to retail markets. The approach adopted was based on the principles that the FSA have previously identified and communicated, and over the year the FSA ensured that the new tools and processes that were developed for conduct supervision were embedded in its wholesale conduct supervision activities. The move to twin peaks supervision in April 2012 enabled the FSA to bring a greater focus, especially in wholesale and investment banking markets, to conduct aspects of supervision and towards the end of the year it focused on finalising aspects of the approach to conduct supervision that the FCA will bring in as they apply to wholesale markets.

Business Model and Strategy Analysis (BMSA)

During the year the FSA developed wholesale content for the new BMSA approach for C1[2] firms including the ‘deep dive’ modules (governance, product and pre-transaction, sales/transaction, post sales/transaction) which the FCA are now applying to a wholesale C1 group. The C2 Peer Group BMSA approach was also adapted to accommodate wholesale activities: the approach is activity-based, i.e. the peer groups are focused on certain activities and contain respective business lines of all firms involved in such activity. The approach for C3 firms has been adapted so that approach is applicable to wholesale as well as retail firms. More focus has also been

[2] http://www.fsa.gov.uk/static/pubs/other/fca-factsheet.pdf

given to wholesale conduct supervision in event driven work, and wholesale metrics for the risk ranking tool for crystallised risks. The FSA also designed and agreed a new approach to group supervision which assumes that risks will be addressed in the same way in standalone firms and the sectoral business units of large firms.

Enforcement action

In November 2012 the FSA fined UBS AG £29.7 million for systems and controls failings that allowed an employee to cause substantial losses totalling US$2.3 billion as a result of unauthorised trading. The trader, Kweku Adoboli, has been convicted of fraud and sentenced to seven years' imprisonment in a high profile case

Domestic policy initiatives

Listing rules

In October 2012 the FSA published a Consultation Paper (CP12/25) *Enhancing the effectiveness of the Listing Regime and feedback* on CP12/2. In the first part of the paper the FSA set out its feedback to CP12/2. This proposed changes to the Listing Rules, Prospectus Rules and Disclosure Rules and Transparency Rules that it had identified as necessary to ensure the operational effectiveness of the Listing Regime was maintained. The second part of CP12/25 proposed changes to enhance the effectiveness of the regime, in response to market debate about the standard of the premium listing.

The proposals represent a significant enhancing of the Listing Rules in the area of governance and centre around four key elements:

- Optimising the entry criteria to the Premium segment so as to maintain the strength of the Premium Listing brand.
- Ensuring that the eligibility requirements continue to apply as meaningful on-going obligations.
- Clarifying the operation of the free-float provisions.
- Providing shareholders with better quality information.

The FSA also worked closely with the Department for Business, Innovation and Skills (BIS) and the Treasury to support the Government's response to the Kay Review of UK equity markets and long-term decision-making.

ATLAS

In the FSA's *2012/13 Business Plan*, it said that developing new IT systems for the UKLA would enable a more efficient allocation of resources, and position the UKLA to respond more flexibly to the dynamic market environment. Following on-going delays to this work, a lack of confidence in the forecast delivery date, and competing resourcing pressures across the IT portfolio, this year the FSA decided to focus instead on the remediation of the existing UKLA systems. Where possible it ensured that the design work undertaken by the project to date has been complete to enable it to be used should the FCA seek to develop new systems in the future.

Listing rules – enforcement action

This year the FSA took enforcement action in five Listing Rules cases reflecting a continuing focus on ensuring appropriate information is given to the market and the regulator in a timely manner.

In March 2013, the FSA fined companies in the Prudential Group (Prudential) a total of £30m for breaching FSA Principles and UKLA Listing Principles. The fines related to Prudential's failure to inform the FSA at the appropriate time that it was seeking to acquire AIA, the Asian subsidiary of AIG, in early 2010. The FSA also censured Tidjane Thiam, Prudential's Group Chief Executive. This was the first time a serving CEO of a FTSE 100 company had been censured by the FSA. In April 2012, the FSA fined Exillon Energy plc £292,950 for failing to identify related party transactions and disclose them to the FSA in a timely manner.

Also in March 2013, the FSA fined Lamprell plc. £2,428,300 for significant failings in its systems and controls, resulting in a failure to identify and disclose inside information in a timely fashion, leading to Listing Rules and other related breaches. This action followed a fine, in February 2013, of £175,000 against Nestor Healthcare Group Limited for failure to take all proper and reasonable steps to secure compliance with the Model Code, a breach which can lead to a perception that individuals within a firm might be misusing information not available to the market. In October 2012, the FSA banned John Blake, managing director of Welcome Financial Services Limited (Welcome), and fined him £100,000 for providing false and misleading information to the market.

Regulated Covered Bonds (RCB)

The UK RCB regime was introduced in March 2008 by the Treasury and supplemented by legally enforceable directions and guidance set out in the RCB sourcebook. Under the regime, issuers must ensure that there is timely payment of claims attaching to the regulated covered bonds, and that the asset pool is of sufficient quality to give investors confidence that, if an issuer fails, there will be a low risk of default in the timely payment by the owner of claims attaching to the bonds.

In January 2013 amendments to the RCB Regulations and RCB sourcebook were introduced to promote transparency and improve investors' understanding of the RCB regime. Under the regime, issuers must ensure:

> *that there is timely payment of claims attaching to the regulated covered bonds, and that the asset pool is of sufficient quality to give investors' confidence that in the event of the failure of the issuer there will be a low risk of default in the timely payment by the owner of claims attaching to the bond.*

In discharging its supervisory duties, the FCA will monitor each programme's ability to meet the regulatory requirements and regularly assesses each issuer's fitness to comply with its obligations under the regime.

Financial Resources Requirements for Recognised Investment Exchanges (RIEs)

In February 2013, the FSA implemented changes to its guidance on how recognised investment exchanges should meet their financial resources requirements. The guidance, as amended, modernised the FSA's approach by moving to a risk-based regime under which RIEs apply stress and scenario-testing tools to calculate an appropriate capital requirement. The FSA consulted RIEs and other interested parties on its proposals through CP11/19, before confirming the changes in July 2012 and working with the RIEs during a subsequent transitional period.

Fit and proper regime for Small Payment Institutions (SPIs)

The failure in October 2010 of Crown Currency Exchange Ltd, which was registered by the FSA as a SPI under the Payment Services Regulations 2009 (PSRs), highlighted the limited powers the FSA has under the PSRs to control the entry of such businesses. The Treasury consulted on the options for improving the protection of consumers within the payment services industry and subsequently laid amendments to the PSRs before Parliament on 10 July 2012, which came into force on 1 October 2012. The PSRs now require those involved in the management of, and with qualifying holdings in, SPIs – for both new applicants, and those registered before 1 October 2012 – to submit to a 'fit and proper' test similar to that applied to Authorised Payment Institutions. Since 1 October 2012 the FSA assessed new SPI applicants against the fit and proper test for SPIs, and began to develop a regime for incumbent SPIs.

International policy initiatives

MiFID II and Markets in Financial Instruments Regulation (MiFIR)

The FSA worked with the Treasury on the negotiation of the MiFID II and MiFIR. It is expected that both pieces of legislation will be finalised in 2013.

The aim of the changes to the existing legislation are to contribute to delivering enhanced transparency of financial markets and reduced systemic risk; to ensure that EU financial markets are robust and resilient in the face of technological change; to ensure that commodity derivative markets provide robust and consistent price discovery mechanisms; and to enhance existing levels of consumer protection.

The FSA also began work, through various different Standing Committees at the European Securities and Markets Authority (ESMA), on collecting information to facilitate the role ESMA will play in drafting technical standards and advising the Commission on delegated acts under the framework legislation.

Market Abuse Directive (MAD) and the Market Abuse Regulation (MAR)

The FSA worked with the Treasury on negotiating the review of MAD which is expected to be finalised in 2013/14. It began work, through the Market Integrity Standing Committee at ESMA, on considering the issues under MAR in areas where ESMA is mandated to draft technical standards and guidelines and where it is expected agreement will be reached during trialogue negotiations. The new legislation (MAR) seeks to widen significantly the scope of instruments covered (including those traded on MTFs and Organised Trading Facilities as well as Regulated Markets), expand the dealing and manipulation prohibitions, including prohibitions against attempted manipulation and manipulation of benchmarks, and strengthen the investigatory and sanctioning powers of competent authorities across the EU.

High frequency trading

Using transaction data the FSA identified the firms most likely to be engaging in high frequency trading and algorithmic trading, along with platforms where such firms operate. This study sought to understand better the risks such firms pose to the FSA's objectives and their compliance with FSA requirements. Firms were assessed based on the FSA's existing rules in conjunction with the ESMA guidelines on automated trading.[3] This work has helped inform the supervisory approach to similar firms.

EMIR

The FSA supported the Treasury in negotiations to finalise the EMIR regulation and made a significant contribution within ESMA to develop the Technical Standards to support the final implementation of the regulation. On 16 August 2012 EMIR came into force and will require anyone who has entered into a derivatives contract to report and effectively risk-manage their derivative positions including by central clearing if the derivative is standardised.

The FSA started working both with existing regulated financial firms and non-financial firms that fell within its regulatory remit for the first time, to support the implementation of the EMIR within the UK during 2013, and develop robust and proportionate supervision of firms in line with the G20 commitments.

In the *2012/13 Business Plan*, the FSA drew particular attention to the need to develop internationally consistent standards and it also participated in the international BCBS-IOSCO Working Group on Margin Requirements. This group issued two consultations in July 2012 and February 2013 to support the development of internationally consistent margin requirements for non-cleared over-the-counter (OTC) derivative trades.

OTC derivatives

The FSA chaired the OTC Derivatives Regulators' Forum (ODRF) where international regulators discuss derivatives reforms around OTC derivatives central counterparties (CCPs) and trade repositories. During the UK's chairmanship of the ODRF, the FSA implemented arrangements for the cooperative oversight of ICE Clear Europe's credit default swap (CDS) clearing service and LCH.Clearnet Ltd.'s SwapClear interest rate swap clearing service.

The FSA also implemented, through the ODRF, an oversight protocol for DDRL, a UK based trade repository for credit, equity, interest rates and foreign exchange derivatives.

The FSA co-chaired the IOSCO Task Force on OTC derivatives and played an active role in monitoring the workstreams, regulatory developments, and investigative proceedings related to the CDS markets as requested by G20 and IOSCO Board.

The FSA was involved in the development of the Legal Entity Identifier (LEI) system which has the objective of introducing unique identification of parties to financial transactions, including OTC derivatives. The FSA was a member of the LEI Regulatory Oversight Committee which was launched in January 2013 and is responsible for overseeing and upholding the governance principles of the global LEI system.

[3] http://www.esma.europa.eu/system/files/esma_2012_122_en.pdf

Resolution mechanism for failing CCPs and Financial Market Infrastructure (FMI)

During 2012 UK authorities worked closely to develop a domestic statutory resolution regime for UK based CCPs and related group companies. This legislation is in place and the regime will take effect once the statutory instruments have been finalised. UK authorities also developed a proposal for a new recognition requirement, which would oblige UK based CCPs to adopt loss allocation rules and recovery plans. The Government published an informal consultation earlier in 2013 on this proposed recognition requirement and UK authorities will work together to review responses and to appropriately progress this workstream. In parallel, the FSA continued to work with UK based CCPs and their clearing members to promote the voluntary adoption of loss allocation arrangements ahead of any statutory developments.

The Committee on Payment and Settlement Systems and IOSCO developed a resolution working group in 2012, which was chaired by the FSA. The group developed a report on the recovery and resolution of FMI published in July 2012.

Commodities

The FSA gave specific focus during the year to ensure that commodity derivatives markets remain efficient and liquid, and ensure that regulators have appropriate information and powers to supervise them effectively. With this in mind the FSA:

- Supported the Treasury in the negotiation of relevant new and amended directives and contributed to commodities related aspects of the EMIR, MiFID and MAD Reviews and working with other Government stakeholders on commodities issues.

- Chaired the ESMA Commodities Task Force, which focused on preparatory work in anticipation of receiving mandates to develop technical standards under MiFID II.

- Continued to co-chair, with the Commodity Futures Trading Commission, the IOSCO group on commodity derivatives, which was formally upgraded to a Standing Committee in 2012. The group published two papers in October. First, the final report on principles for oil price reporting agencies[4], representing a significant milestone in the wider international regulatory focus on benchmarks. Second, a review of the implementation of the principles for the regulation and supervision of commodity derivatives markets.[5]

- It also looked ahead to the implementation of the Regulation on Energy Market Integrity and Transparency legislation timed for summer 2013 that will affect the approach to market conduct in the commodities markets and took steps to begin revising policies and procedures to take account of the changes.

Short selling regulation (SSR)

The FSA implemented the short selling regulation (Level 1), which became directly applicable in the UK from November 2012. The SSR prohibits firms from:

- entering into naked short positions in shares and sovereign debt unless they have arrangements in place with a counterparty to ensure delivery of the stock at the delivery date; and

- entering into naked short positions in sovereign CDS; and

[4] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD391.pdf
[5] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD393.pdf

The nominal threshold levels at which firms would be required to notify us of their net short positions in relation to holdings of sovereign debt and sovereign CDS were also set at this stage.

Following delivery of the Level 2 binding technical standards in early 2012, the UK implemented processes for issuers to make the following notifications and disclosures from 1 November 2012.

Additionally two Q&As were published by ESMA in October 2012 and January 2013 and the FSA assisted on drafting the ESMA guidelines on Market Maker and Primary Dealer Exemptions that was published on 1 February 2013.

The FSA was given the power to instigate prohibitions on short selling in instruments that fall significantly in price and it used this power twice in response to prohibitions by other competent authorities.

Credit Ratings Agencies (CRAs)

CRAs continue to be subject to considerable regulatory scrutiny because of the widespread use of ratings. A European framework of regulation was developed in 2009. It has subsequently been updated with ESMA now carrying out the registration and supervision of CRAs.

In 2011, the European Commission proposed further enhancements to the European regulations on CRAs to reduce mechanistic reliance on credit ratings, improve the frequency and transparency of sovereign debt ratings, eliminate conflicts of interest and enhance competition between ratings agencies. The FSA supported the Treasury throughout the negotiations and the new Regulation was agreed on 16 January 2013. The FSA also supported ESMA in developing the technical standards needed for implementation.

Corporate governance for listed issuers

In December 2012 the EU Commission published proposals (the EU Corporate Governance Action Plan) to strengthen some aspects of corporate governance for listed issuers. The Plan sets out a range of initiatives which will, if taken forward, be implemented through changes to existing directives. The FSA continued to work with the BIS and the Financial Reporting Council on this issue.

Prospectus Directive

In preparation to implement the measures in the Prospectus Directive Amending Directive in the UK by 1 July 2012, the FSA published its joint Policy Statement, PS12/9, with the Treasury in May 2012. This gave feedback from the consultation paper CP11/98, published in December 2011, and set out the changes the FSA made to the Prospectus Rules and which the Treasury made to the Financial Services and Markets Act 2000, in order to implement the Prospectus Directive Amending Directive.

The FSA worked with ESMA on developing Technical Standards arising from the Prospectus Directive Amending Directive in relation to the ESMA CP on Supplements, which was published in March 2013.