HM TREASURY

A consultation on the implementation of EU Directive 2009/44/EC on settlement finality and financial collateral arrangements

August 2010

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Contents

1 Introduction

1.1 On 6 May 2009 the European Parliament and Council adopted Directive 2009/44/EC (the "Amending Directive"), which amends Directive 98/26/EC on settlement finality in payment and securities settlement systems (the "SFD") and Directive 2002/47/EC on financial collateral arrangements (the "FCD").

1.2 This consultation document seeks views on proposals for implementation in the UK of the Amending Directive.

UK implementation

1.3 Member states have until **30 December 2010** to adopt and publish their implementing measures, which are to apply from **30 June 2011.**

1.4 In order to transpose the Amending Directive into UK law, we intend to amend the previous UK legislation which implements the SFD and the FCD.

1.5 A draft of the proposed Statutory Instrument implementing the Amending Directive (hereafter "the amending SI") is set out at Annex A.

1.6 Broadly speaking we do not propose to use the implementation process to make any changes beyond those required by the Directive. However we are taking the opportunity to seek views on whether further modification to the law relating to floating charges which are "collateral security charges" may be justified, and on protections for participants in non-EEA "systems".

Background and key points

1.7 The SFD and FCD provide a key underpinning for the systemic robustness of the financial markets.

1.8 The FCD provides a uniform legal framework for the (cross border) use of financial collateral. In particular, it reduces the formalities required when providing or taking collateral and facilitates the realisation of the collateral in the event of the collateral provider's default. The original FCD only covers arrangements where the collateral is either cash or financial instruments; it does not cover arrangements governing other types of collateral, for example, land. The FCD was implemented in the UK via the Financial Collateral Arrangements (No.2) Regulations 2003[1], (hereafter "the 2003 regulations").

1.9 The SFD is aimed at reducing the systemic risk associated with participation in payment and securities settlement systems, and in particular the risk linked to the insolvency of a participant in such a system. The SFD applies to payment and securities settlement systems as well as any participant in such a system, and to collateral security provided in connection with the participation in a system, or provided to the central banks of the Member States or the European Central Bank in their functions as central banks. The SFD was implemented in the UK

[1] As amended by S.I. 2009/2462;

via the Financial Markets and Insolvency (Settlement Finality) Regulations 1999, S.I. 1999/2979[2] (hereafter "the 1999 regulations")

1.10 The Amending Directive is the outcome of consultations carried out on the operation of both the SFD and FCD. The Commission produced a report in 2005 on the operation of the SFD and in 2006 on the operation of the FCD. Both reports concluded that the Directives had proved a success. However, the need for some improvements was identified. The report on the SFD identified a need for clarification in certain respects. The report on the FCD focussed on market developments regarding the use of credit claims as collateral.

1.11 Due to the changing post trade environment, and the close links between the two directives, it was felt that they should be amended together under a single amending directive.

1.12 The changes made by the Amending Directive are discussed in detail in Chapter 2, along with the proposals for their implementation in the UK. Chapter 3 addresses further possible changes relating to floating charges and protections for participants in non-EEA systems. Chapter 4 explains how to respond to this consultation document and includes a summary of the consultation questions.

1.13 Consultees should note that the proposal in Chapter 2 to amend the Bankruptcy and Diligence etc (Scotland) Act 2007 is subject to discussions with the Scottish Executive and Scottish Parliamentary Counsel.

Box 1 Some of the principal changes to the original directives:

- **Introducing the concept of interoperable systems into law.** The Amending Directive changes various definitions and introduces various terms to ensure interoperable systems are brought into the regime, with relevant protections clarified or extended where appropriate.
- **Providing clarity on calendar days and moments of entry.** The Amending Directive clarifies that the SFD's protections apply to settlements that take place on the same business day that insolvency proceedings are commenced, and obliges settlement systems to seek to co-ordinate their rules regarding the moment of entry and irrevocability of transfer orders.
- **Bringing credit claims into the scope of the FCD.** The Amending Directive brings credit claims (i.e. loans) into the scope of the FCD's protections.

[2] As amended by S.I. 2001/3929; 2002/1555; 2003/2096; 2006/50; 2006/3221; 2007/108; 2007/126; 2007/832; 2007/1655; 2009/1972;

2 Main proposed changes

2.1 This section takes each of the main measures in the Amending Directive and explains how we intend to implement it into UK law. In addition we are taking the opportunity to propose some technical changes to the 1999 and 2003 regulations, for example to reflect changes to legislation or to remove areas of possible ambiguity.

2.2 We welcome comments on any aspect of the proposed implementation, and in particular we would welcome information from consultees on the likely costs and benefits of the implementation measures, where applicable. Where we are seeking views on a specific point, we have inserted a consultation question.

Amendments relating to Settlement Finality

Embedding the concept of interoperability into law

2.3 When the original SFD was passed, systems operated on an almost exclusively national and independent basis. To accommodate the onset of inter-linkages between systems, the Amending Directive changes various definitions and introduces various terms to ensure interoperable systems are brought into the regime with relevant protections clarified or extended where appropriate. Specifically, the Amending Directive:

- Defines "interoperable systems", as "two or more systems whose system operators have entered into an arrangement with one another that involves cross-system execution of transfer orders". The amending SI (in regulation 2 (2)(a)) reproduces the definition in the Amending Directive, and further introduces the term into the relevant parts of the 1999 Regulations to ensure that the insolvency-related provisions which apply to systems also apply to interoperable systems.
- Amends the definition of "indirect participant" to include linked systems. Currently, the SFD allows Member States to choose to extend the protection of the SFD to indirect participants by designating them as full-fledged "participants". However this possibility only applied to credit institutions which are members of payment systems. There was considered to be no obvious reason for this limitation and so the Amending Directive extends the possibility to central counterparties, settlement agents, clearing houses and system operators. The amending SI reflects this in regulation 2(2)(e). A decision by a Member State to treat an indirect participant as a participant does not affect the liability of the participant, as regulation 2(8) makes clear.
- Defines "system operator" – as distinct from the more general term "system" – to make it clear who is in charge of running the system and thus who bears the legal responsibility for its operation. The amending SI defines this term, and inserts it to the relevant parts of the 1999 regulations.

In accordance with the definition of "interoperable systems" in the Amending Directive, and to prevent any uncertainty arising from the introduction of the term "interoperable system" paragraph (16) of regulation 2 of the amending SI clarifies that an arrangement between interoperable systems shall not constitute a system.

Clarifying what overnight settlement means

2.4 The original SFD provided that transfer orders shall be legally enforceable in the event of a participant's insolvency, as long as they were entered into the system, prior to the onset of insolvency proceedings or, to the extent that they were entered into the system *after* the onset of insolvency proceedings, that they were carried out *on the same day* as the insolvency proceedings were commenced.

2.5 Given that calendar days do not always coincide with systems' business days or operating cycles, the application of the SFD protection may be problematic: for example, a transfer order may be entered into a system on one day, yet (by reason of night-time or overnight processing), only be settled in the early hours of the next day, arguably rendering the transfer order outside SFD protection even though it was settled during the same business/operating cycle of the system.

2.6 To address this, the Amending Directive (Article 1(5)(i)) defines a business day as covering "both day and night-time settlements" and encompassing "all events happening during the business cycle of a system". The amending SI, via regulation 2(2)(a) and 2(12)(c)(i), incorporates this change into the 1999 regulations.

Removing ambiguity on moment of entry

2.7 In an interoperable system there is potential for uncertainty over the point at which a transfer order becomes irrevocable: if two interoperable systems have different rules for establishing the relevant entry/irrevocability point, which rule applies for the purposes of insolvency protections?

2.8 To deal with this potential problem, the Amending Directive provides that systems should, as far as possible, coordinate the rules determining the entry point and irrevocability point for transfer orders entering the system. This is reflected via paragraph (16)(d) of Regulation 2 of the amending SI, which directly incorporates the requirement in the Amending Directive that "where the system has one or more interoperable systems, the [relevant rules] shall, as far as possible, be co-ordinated with the rules of those interoperable systems".

Question 1

What costs (size and nature) will system operators need to incur in order to achieve compliance with the requirement to coordinate their rules on irrevocability?

Bringing Electronic Money Institutions in scope

2.9 The Amending Directive sought to clarify that Electronic Money Institutions (ELMIs) are in the scope of the SFD. The concept of ELMI[1] did not exist at the time of the adoption of the SFD. To the extent that these institutions might have the right to participate directly in a payment system, the Commission considered that they should enjoy the same protections that are enjoyed by existing participants of that system.

2.10 The Amending Directive addresses this by defining credit institutions by reference to the definition in Article 4(1) of Directive 2006/48/EC. At the time when the Amending Directive was adopted, this definition included both deposit takers, and ELMIs. However Article 4(1) of

[1] ELMIs were introduced by the E-Money Directive (2006/46/EC)

2006/48/EC has since been amended to remove the reference to ELMIs. It is therefore no longer clear that they are within the scope of the SFD[2].

2.11 Given the clearly expressed intention of the Commission in the proposal for the Amending Directive that ELMIs should be brought within the scope of the SFD[3], and the meaning of "credit institution" at the date when the Amending Directive was adopted, we propose to make express provision to clarify the position of ELMIs. This is done in Regulation 2(2)(f), which provides that an "institution" includes ELMIs for the purpose of the 1999 Regulations.

Question 2

Do you agree that electronic money institutions should be brought within the scope of the Settlement Finality regulations?

Introducing credit claims as a type of collateral security

2.12 In order to reflect the incorporation of credit claims into the scope of the FCD (see discussion below) we have, in accordance with the Amending Directive, updated the definition of "collateral security" in the 1999 Regulations to cover credit claims, which we define using the definition in the AmendingDirective (see regulation 2(2)(b) of the amending SI).

Amendments relating to Financial Collateral

Introduction and definition of credit claims

2.13 The Amending Directive extends the definition of "financial collateral" in the FCD to include credit claims (i.e. loans, broadly speaking[4]). This ensures that when credit claims are used as financial collateral, the collateral taker gains certain protections against the insolvency of the collateral provider and, additionally, that various formalities need not be complied with as a precondition for offering the credit claims as valid collateral.

2.14 The intention of this measure is to increase the pool of available collateral that banks can use, with possible attendant benefits to borrowers via increased competition and better availability of loans.

2.15 The SI principally implements this measure by:

- substituting in the definition of "financial collateral" in regulation 3 of the 2003 regulations, for "cash and financial instruments", "cash, financial instruments or credit claims"
- inserting in the appropriate place in regulation 3 of the 2003 regulations, the definition of credit claims contained in Article 2 (5)(a)(ii) of the Amending Directive.

Amendment of Scottish law on registration of charges

2.16 We intend to amend the Bankruptcy and Diligence etc (Scotland) Act 2007 (the "2007 Act") to ensure that Scottish floating charges which are created or arise under a security financial collateral arrangement are created when the document creating the charge is executed, not when the charge is registered on the Scottish Register of Floating Charges.

[2] The version of directive 2006/48/EC in force when the Amending Directive was adopted (and when it came into force), was different to that in force now, and included a reference to "an electronic money institution within the meaning of Directive 2000/46/EC". That reference has now been deleted (and indeed Directive 2000/46/EC has now been repealed and replaced by Directive 2009/110/EC).

[3] http://ec.europa.eu/internal_market/financial-markets/docs/proposal/sfd_fcd_proposal_en.pdf (see paragraph 4.4)

[4] The Amending Directive (Article 2(5)(a)(ii)) defines credit claims as "pecuniary claims arising out of an agreement whereby a credit institution…grants credit in the form of a loan"

2.17 This reflects the provision at Article 3 of the FCD which requires that Member States shall not require that the creation or validity of a financial collateral arrangement or the provision of financial collateral be dependent on a formal act such as registration.

2.18 The amendments to the 2007 Act necessary to achieve this, and consequential amendments, are set out in regulation 4 of the amending S.I.

Question 3

Do you have any comments on draft regulation 4 of the amending SI?

Disapplication of foreign insolvency law

2.19 At present the insolvency protections in the 2003 regulations are principally effected by the disapplication of various specific statutory provisions of UK insolvency law: leaving open the possibility (albeit remote) that holders of collateral provided by a foreign entity would not be protected (in the UK) against the bankruptcy of that entity.

2.20 Regulation 3(3) of the amending SI accordingly ensures that an insolvency order given by a foreign court, or an act of a foreign office-holder cannot be recognised or given effect to by a UK court if such an order or act could not be made or done by a UK court or office-holder. The same provision was made in relation to transfer orders and collateral security in regulation 25 of the 1999 regulations.

Question 4

Do you agree that provision should be made to ensure that foreign insolvency orders or acts cannot be recognised or given effect to by the UK courts in circumstances where an equivalent order or act could not be made or done by a court in the UK because of the protections contained in the 2003 Regulations?

No exclusion for credit claims where the debtor is a consumer or small business

2.21 The Amending Directive (Article 2 (4)(d)) gives Member States the option (other that where the collateral giver or taker is a central bank) of excluding credit claims from the FCD regime where the debtor covered by the credit claim is a consumer or a small or micro business.

2.22 We do not propose to exercise this option. Existing consumer credit protections will continue to apply. Moreover in the UK such claims are already capable of and, we understand, are being used as financial collateral irrespective of the application of the FCD regime.

Question 5

Do you agree that credit claims should not be exempted from the protections of the FCD where the debtor is a consumer or small business?

3 Further possible changes for discussion

Floating Charges

3.1 The 2003 regulations, in line with the FCD, disapply a number of UK legislative provisions and common law rules which require formalities before a financial collateral arrangement is perfected and/or might affect the enforcement of financial collateral arrangements. In particular, the obligation to register certain charges does not apply where the charge arises under a security financial collateral arrangement. In addition, the 2003 regulations disapply restrictions on the enforcement of security, which would otherwise apply when a company is subject to administration proceedings or other insolvency proceedings.

3.2 However, these provisions only apply in relation to floating charges if they satisfy the definition of "security interest" in the 2003 Regulations and under which the financial collateral subject to the floating charge must be "delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral-taker or a person acting on its behalf." Legal opinion appears to be that it is unclear how many floating charges satisfy this possession or control test.

3.3 Extending the regulations to all floating charges would raise questions about the appropriate level of protection for third parties, particularly unsecured creditors who (in the absence of a registration requirement) would be unaware that a floating charge had been created by the company, and who may consequently believe their claim to be more senior than in fact it is. This sort of consideration is acknowledged by the FCD which cites (at Recital 10) the importance of balancing market efficiency, on the one hand, and the safety of parties to the arrangements and of third parties, on the other, thereby helping to avoid – among other things – the risk of fraud.

3.4 Since the FCD was implemented the Treasury has acquired, under the Banking Act 2009, the power to modify the law relating to financial collateral. We are taking the opportunity to seek views on whether the scope of the FCD protections for floating charges remains appropriate. A particular issue which has been identified in the UK is that a type of floating charge granted in favour of CREST settlement banks (known as a "system charge") may not be included in the scope of the protections.

3.5 The daily average value of securities moving through the CREST system in March 2010 was in the order of £1,442 billion, while the daily average value of cash moving through CREST was in the order of £908 billion, including self-collateralising repo transactions[1]. CREST settlement banks assume their exposures, in the great majority of cases, in reliance on floating charges from CREST members over their securities and other entitlements in CREST.

3.6 Given the extent of the use of system charges under CREST, there may be a case for bringing system charges within the scope of the protections of the 2003 regulations. One way of

[1] Market performance statistics for Euroclear UK and Ireland available on www.euroclear.com

achieving this might be to give protection to floating charges which qualify as "collateral security charges" under the 1999 Regulations[2].

3.7 Respondents should be aware that the BIS department has also referred to this issue in its recent consultation[3] on registration of company charges, asking whether floating charges which include financial collateral should be exempt, and noting the important role they play in infrastructure operations in financial markets. While such an exemption would address some industry concerns over registration, it would not address concerns about the extent of insolvency protections enjoyed by floating charges.

Question 6

Do you consider that floating charges which are "collateral security charges" within the meaning of the 1999 Regulations should be brought within the scope of the 2003 Regulations?

SFD: Extending protections to non-EEA settlement systems

3.8 Recital (7) of the SFD provides that "Member States may apply the provisions of this Directive to their domestic institutions which participate directly in third country systems and to collateral security provided in connection with such systems".

3.9 The 1999 regulations provide, in Regulation 26, some protection for UK participants in systems designated in other *EEA states*: In particular, overseas orders effected through another EEA designated system, and equivalent overseas security provided to secure rights and obligations arising in connection with such a system, have the same protections as transfer orders effected through and collateral security provided in connection with a UK designated system.

3.10 However there is no protection for UK participants in settlement and payment systems established in *third countries*. This raises several questions - first, should any protection be extended to participants in non-EEA settlement systems, and then, which systems should benefit from protection. For example, such systems might be identified or limited to:

- those designated by the relevant UK competent authority; or-
- those third country systems which meet particular criteria based on or equivalent to those contained in the SFD, or in the alternate designated by the relevant public authorities in the third country concerned (this could be based on for example importance from a systemic risk perspective or the reduction of risk to the stability of the financial system.

Question 7

Would you support the extension of the 1999 regulations to cover third country settlement systems? If so, what criteria should govern which systems are protected?

[2] Part 1, Regulation 2(1)

[3] http://www.bis.gov.uk/Consultations/registration-of-charges

4 How to respond

Summary of Consultation Questions:

1 What costs (size and nature) will system operators need to incur in order to achieve compliance with the requirement to coordinate their rules on irrevocability?

2 Do you agree that electronic money institutions should be brought within the scope of the Settlement Finality regulations?

3 Do you have any comments on draft regulation 4 of the amending SI?

4 Do you agree that provision should be made to ensure that foreign insolvency orders or acts cannot be enforced by the UK courts in circumstances where an equivalent order made by a court in the UK could not be enforced because of the protections given in the 2003 Regulations?

5 Do you agree that credit claims should not be exempted from the protections of the FCD where the debtor is a consumer or small business?

6 Do you consider that charges which are "collateral security charges" within the meaning of the 1999 regulations should be brought within scope of the 2003 regulations?

7 Would you support the extension of the 1999 regulations to cover third country settlement systems? If so, what criteria should govern which systems are protected?

4.1 We invite comments on the issues and questions set out in this consultation paper, which includes a draft Statutory Instrument and Impact Assessment by 29 October. Please send responses to:

Securities and Markets Team

International & Finance Directorate
HM Treasury
1 Horse Guards Road
London
SW1 2HQ

Email: SAMteam@hmtreasury.gsi.gov.uk

4.2 When responding please state if you are responding as an individual or representing the views of an organisation. In accordance with the code of practice on open government comments will be made publicly available unless respondents specifically request otherwise.

Confidentiality disclosures

4.3 Information provided in response to this consultation, including personal information, might be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act (DPA) and the Environmental Information Regulations 2004. If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply with and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality will be maintained in all circumstances.

4.4 An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department. Your personal data will be processed in accordance with the DPA, and in the majority of circumstances, this will mean that your personal data will not be disclosed to third parties.

Any Freedom of Information Act queries should be directed to:

Correspondence and Enquiry Unit
Freedom of Information Section
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: (+44) (0) 20 7270 4558

Fax: (+44) (0) 20 7270 4681

Email: public.enquiries@hm-treasury.gov.uk

Code of practice on consultation

4.5 This consultation is being conducted in line with the criteria in the Government's Code of Practice on Consultation. The seven consultation criteria are:

- when to consult – formal consultation should take place at a stage when there is scope to influence the policy outcome.
- Duration of consultation exercises – consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
- Clarity of scope and impact – consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
- Accessibility of consultation exercises – consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
- The burden of consultation – keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.

- Responsiveness of consultation exercises – consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.

Capacity to consult – officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

If you feel this consultation does not fulfil these criteria, please contact:

Angela Carden

HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Email: angela.carden@hmtreasury.gsi.gov.uk

A Draft implementing instrument (SI)

STATUTORY INSTRUMENTS

2010 No.

FINANCIAL SERVICES AND MARKETS

The Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010

Made - - - -	***
Laid before Parliament	***
Coming into force - -	***

The Treasury are a government department designated(**a**) for the purposes of section 2(2) of the European Communities Act 1972(**b**) in relation to measures—

(a) relating to investment firms and to the provision of investment services and to the operation of regulated markets and clearing or settlement systems;

(b) relating to payment systems; and

(c) relating to collateral security, including collateral security provided to the central banks of Member States or to the European Central Bank.

The Treasury make these Regulations in exercise of the powers conferred by that section.

Citation and commencement

1.—(1) These Regulations may be cited as the Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010, and come into force on [ ].

Amendment of the Financial Markets and Insolvency (Settlement Finality) Regulations 1999

2.—(1) The Financial Markets and Insolvency (Settlement Finality) Regulations 1999(**c**) are amended as follows.

(2) In regulation 2(1)—

(a) insert each of the following definitions at the appropriate place—

(**a**) S.I. 1993/2661, S.I. 1998/2793 and S.I. 2003/1888.
(**b**) 1972 c. 68.
(**c**) S.I. 1999/2979, amended by S.I. 2001/3929, 2002/1555, 2003/2096, 2006/50, 2006/3221, 2007/32, 2007/108, 2007/126, 2007/1655, 2009/1972.

""business day" shall cover both day and night-time settlements and shall encompass all events happening during the business cycle of a system;"

""credit claims" means pecuniary claims arising out of an agreement whereby a credit institution grants credit in the form of a loan;"

""interoperable system" in relation to a system ("the first system"), means a second system whose system operator has entered into an arrangement with the system operator of the first system that involves cross-system execution of transfer orders;"

""system operator" means the entity or entities legally responsible for the operation of a system. A system operator may also act as a settlement agent, central counterparty or clearing house;";

(b) in the definition of "collateral security", after "including" insert "credit claims and";

(c) in the definition of "credit institution" for "Article 4(1)(a)" substitute "Article 4(1)";

(d) in the definition of "default arrangements", after "participant" insert "or a system operator of an interoperable system".

(e) for the definition of "indirect participant" substitute—

""indirect participant" means an institution, central counterparty, settlement agent, clearing house or system operator—

(a) which has a contractual relationship with a participant in a designated system that enables the indirect participant to effect transfer orders through that system, and

(b) the identity of which is known to the system operator;"

(f) in the definition of "institution", insert after sub-paragraph (a)—

"(aa) an electronic money institution within the meaning of Article 2.1 of Council Directive of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC (No 2009/110/EC);(**a**)"

(g) in the definition of "participant", after sub-paragraph (a), insert—

"(aa) a system operator;";

(h) in the definition of "transfer order", after "a central bank" insert ", a central counterparty".

(3) In regulation 4, after "designated system" insert "and identifying the system operator of that system".

(4) In regulation 5—

(a) in paragraph (2), after "charge" insert "the system operator of";

(b) in paragraph (3)(b)—

(i) for "system continues" substitute "system and its system operator continue";

(ii) for "is complying" substitute "are complying";

(iii) for "it is subject" substitute "they are subject".

(5) In regulation 7(1)(b)—

(a) after "the system" insert "or the system operator of that system";

(b) for "it is subject" substitute "they are subject".

(6) In regulation 7(4), after "consent of the" insert "system operator of the".

(7) In regulation 8(2) insert at the end "and to the system operator of that system".

(8) In regulation 9, after paragraph (1), insert—

(**a**) OJ L 257, 10.10.2009, p7.

"(2) Where a designating authority, in accordance with paragraph (1), treats an indirect participant as a participant in a designated system the liability of the participant through which that indirect participant passes transfer orders to the designated system, is not affected.".

(9) In regulation 10—

(a) for paragraph (1), substitute—

"(1) The system operator of a designated system shall, when that system is declared to be a designated system, provide to the designating authority in writing a list of the participants (including the indirect participants) in the designated system and shall give written notice to the designating authority of any amendment to the list within seven days of such amendment.";

(b) in paragraphs (2), (3), (4) and (5), for "a designated system" in each place where it occurs substitute "the system operator of a designated system".

(10) In regulation 13(2)—

(a) for sub-paragraph (a), substitute—

"(a) insolvency proceedings in respect of a participant in a designated system, or of a participant in a system which is an interoperable system in relation to that designated system;"

(b) at the end of paragraph (2)(b), insert "and";

(c) after paragraph (2)(b), insert—

"(c) insolvency proceedings in respect of a system operator of a designated system or of a system which is an interoperable system in relation to that designated system;"

(11) In regulation 14—

(a) in paragraph (1)(b), after "designated system" insert "or of an interoperable system of a designated system";

(b) in paragraph (1)(d), after "designated system" insert "or an interoperable system of a designated system";

(c) in paragraph (2)(c), after "designated system" insert "or an interoperable system of a designated system";

(d) for paragraph (5)(a)(iv), substitute—

"(iv) paragraph 100(3) of Schedule B1 to the Insolvency (Northern Ireland) Order 1989, Article 31(4) of that Order, as it has effect by virtue of Article 4(1) of the Insolvency (Northern Ireland) Order 2005, and Article 50 of the Insolvency (Northern Ireland) Order 1989; and"

(e) in paragraph (6), after "participant" insert ", system operator".

(12) In regulation 20—

(a) in paragraph (1)(a), for "in respect of that participant" substitute—

"in respect of—

(i) that participant;

(ii) a participant in an interoperable system of the designated system; or

(iii) a system operator which is not a participant in the designated system, or".

(b) in paragraph (1)(b) and (c), after "that participant" insert ", a participant in an interoperable system of the designated system or a system operator of that designated system";

(c) in paragraph (2)—

(i) in sub-paragraph (a), for "same day" substitute "same business day of the designated system";

(ii) in sub-paragraph (b), for "the settlement agent, the central counterparty or the clearing house" substitute "the system operator";

(d) in paragraph (3), for "the relevant settlement agent, central counterparty or clearing house" substitute "the relevant system operator".

(13) In regulation 22(1), for "the system" substitute "the system operator of that designated system".

(14) In regulation 23(a)—

(a) after "a participant" insert ", a system operator";

(b) after "the participant" insert ", the system operator".

(15) In regulation 26—

(a) in paragraph (1)(b), omit "in connection with a designated system";

(b) for paragraph (2)(b), substitute—

"(b) "equivalent overseas security" means any realisable assets provided under a charge or a repurchase or similar agreement, or otherwise (including credit claims and money provided under a charge)—

(i) for the purpose of securing rights and obligations potentially arising in connection with such a system, or

(ii) to a central bank for the purpose of securing rights and obligations in connection with its operations in carrying out its functions as a central bank.".

(16) In the Schedule—

(a) in paragraph 1, insert at the end—

"(5) An arrangement entered into between interoperable systems shall not constitute a system.";

(b) in paragraph 3, for "system" in both places where it occurs, substitute "system operator";

(c) in paragraph 4, for "the system", substitute "the system operator";

(d) in paragraph 5, after sub-paragraph (1), insert—

"(1A) Where the system has one or more interoperable systems, the rules required under paragraph (1)(a) and (b) shall, as far as possible, be co-ordinated with the rules of those interoperable systems.

(1B) The rules of the system which are referred to in paragraph (1)(a) and (b) shall not be affected by any rules of that system's interoperable systems in the absence of express provision in the rules of the system and all of those interoperable systems.".

Amendment of the Financial Collateral Arrangements (No 2) Regulations 2003

3.—(1) The Financial Collateral Arrangements (No 2) Regulations 2003 are amended as follows.

(2) In regulation 3—

(a) insert in the appropriate place—

""credit claims" means pecuniary claims which arise out of an agreement whereby a credit institution, as defined in Article 4(1) of Directive 2006/48/EC of the European Parliament and of the Council relating to the taking up and pursuit of the business of credit institutions (recast), including the institutions listed in Article 2 of that Directive, grants credit in the form of a loan(**a**);";

(b) in the definition of "financial collateral", for "cash or financial instruments" substitute "cash, financial instruments or credit claims";

(**a**) OJ No L 177, 30.6.2006, p1 – 200.

(c) in the definitions of "security financial collateral arrangement" and "security interest", after "excess financial collateral" insert "or to collect the proceeds of credit claims until further notice".

(3) After regulation 15, insert—

"Insolvency proceedings in other jurisdictions

15A.—(1) The references to insolvency law in section 426 of the Insolvency Act 1986 (co-operation between courts exercising jurisdiction in relation to insolvency) include, in relation to a part of the United Kingdom, this Part of these Regulations and, in relation to a relevant country or territory within the meaning of that section, so much of the law of that country or territory as corresponds to this Part.

(2) A court shall not, in pursuance of that section or any other enactment or rule of law, recognise or give effect to—

(a) any order of a court exercising jurisdiction in relation to insolvency law in a country or territory outside the United Kingdom, or

(b) any act of a person appointed in such a country or territory to discharge any functions under insolvency law,

in so far as the making of the order or the doing of the act would be prohibited by this Part in the case of a court in England and Wales or Scotland, the High Court in Northern Ireland or a relevant office holder.

(3) Paragraph (2) does not affect the recognition of a judgment required to be recognised or enforced under or by virtue of the Civil Jurisdiction and Judgments Act 1982(**a**) or Council Regulation (EC) No 44/2001 of 22nd December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters,(**b**) as amended from time to time and as applied by the Agreement made on 19th October 2005 between the European Community and the Kingdom of Denmark on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.(**c**)".

(4) In regulation 16, at the end, insert—

"(5) This regulation does not apply in relation to credit claims."

Registration of charges: Scotland

4.—(1) The Bankruptcy and Diligence etc. (Scotland) Act 2007(**d**) is amended as follows.

(2) In section 38 (creation of floating charges)—

(a) in subsection (3), after "subsection (3A)" insert ", subsection (3B)";

(b) after subsection (3A) insert—

"(3B) If a floating charge is created or otherwise arises under a security financial collateral arrangement, it is created only when the document granting the floating charge is executed by the company granting the charge."

(3) In section 39 (advance notice of floating charges), for subsection (4) substitute—

"(4) This section does not apply—

(a) where a company proposes to grant a floating charge in favour of a central institution;

(b) where a floating charge is created or otherwise arises under a security financial collateral arrangement."

(**a**) 1982 c. 27.
(**b**) OJ L 12, 16.1.2001, p 1-23.
(**c**) OJ L 299 16.11.2005, p62.
(**d**) 2007 asp 3, as amended by the Banking Act 2009 (c.1) s. 253.

(4) In section 42 (assignation of floating charges), after subsection (4), insert—

"(5) This section does not apply to the assignation (whether in whole or to a specified extent) of a floating charge which was created or arises under a financial collateral arrangement."

(5) In section 43 (alteration of floating charges), in subsection (4A)—

(a) at the end of paragraph (b), insert ", or";

(b) after paragraph (b), insert—

"(c) the floating charge was created or otherwise arises under a security financial collateral arrangement."

(6) In section 44 (discharge of floating charges), for subsection (4), substitute—

"(4) This section does not apply where the floating charge to be discharged (whether in whole or to a specified extent)—

(a) is or has been held by a central institution, or

(b) was created or otherwise arises under a security financial collateral arrangement."

(7) In section 47 (interpretation), after the definition of "fixed security", insert—

"security financial collateral arrangement" has the same meaning as in regulation 3 of the Financial Collateral Arrangements (No 2) Regulations 2003;".

Name
Name

Date

Two of the Lords Commissioners of Her Majesty's Treasury

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations implement Directive 2009/44/EC of the European Parliament and of the Council amending Directive 1998/26/EC on settlement finality in payment and securities systems and Directive 2002/47/EC on financial collateral arrangements (OJ L146, 10.6.09, p 37). The Directive seeks to make further provision for linked or "interoperable" systems, and ensure that credit claims may be used as financial collateral.

Regulation 2 amends the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (S.I. 1999/2979)("the 1999 Regulations"). Paragraph (2) amends the definition of "collateral security" to include credit claims, and defines credit claims. It also amends the definitions of participant and indirect participant, and adds new definitions of "business day", "interoperable system" and "system operator".

Paragraphs (3) to (7), (9) and (16) amend regulations 4 to 8, and 10 of, and paragraphs 3 and 4 of the Schedule to, the 1999 Regulations so that obligations previously imposed on the designated system itself are now imposed on the system operator of that system. Paragraph (8) clarifies the liability of a participant through which an indirect participant passes transfer orders to the designated system.

Paragraphs (10) and (11) amend regulations 13 and 14 of the 1999 Regulations so that the protection given in relation to insolvency proceedings in respect of a participant in a designated system is now extended to insolvency proceedings in respect of the system operator of a designated system, and in respect of participants in interoperable systems of a designated system. Paragraph (12) amends regulation 20 so that modifications made to the law of insolvency cease to apply to a transfer order entered into a designated system following the insolvency not only of a participant in that system, but also of a participant in an interoperable system and of a system operator who is not a participant in the system, unless the transfer order is carried out on the same business day as the insolvency and the system operator did not have notice of it when the order was settled.

Paragraph (13) amends regulation 22 to require the system operator of a designated system to be informed when a court makes an insolvency order in relation to a participant in a designated system. Paragraph (14) amends regulation 23 so that the rule in that regulation for determining the applicable law in relation to securities held as collateral security also applies in relation to securities provided to a system operator.

Paragraph (15) amends regulation 26 to ensure that Part 3 of the Regulations applies to equivalent overseas security provided to a central bank just as it applies to such security provided in connection with a designated system, and amends the definition of "equivalent overseas security" accordingly.

Paragraph (16) amends paragraphs 1, 3 and 4 of the Schedule to the 1999 Regulations to clarify what is a "system" for the purpose of the regulations. It also amends paragraph 5 of the Schedule to require the rules of interoperable systems in relation to the finality and revocation of a transfer order to be co-ordinated as far as possible.

Regulation 3 amends the Financial Collateral (No 2) Regulations 2003 (S.I. 2003/3226) ("the 2003 Regulations"). Paragraph (2) inserts a new definition of "credit claim" and amends the definitions of "financial collateral" and "security financial collateral arrangements" to include credit claims which are provided as financial collateral.

Paragraph (3) ensures that an insolvency order made by a foreign court, or an act of a foreign insolvency office-holder cannot be enforced by a UK court if such an order or act could not be made by a UK court or office-holder. Paragraph (4) ensures that the provision in the 2003 Regulations in relation to the right of use does not apply to credit claims.

Regulation 4 amends the Bankruptcy and Diligence etc. (Scotland) Act 2007 (asp 3) to ensure that floating charges which are created or arise under a security financial collateral arrangement are created when the document creating the charge is executed, not when the charge is registered on the Scottish Register of Floating Charges, and makes further consequential amendments in relation to such charges.

An Impact Assessment of the effect of this instrument on the costs of business has been prepared and may be obtained from the Financial Regulation Strategy Team, HM Treasury, 1 Horse Guards Road, London SW1A 2HQ. It is also available on HM Treasury's website (www.hm-treasury.gov.uk).

B Draft Impact Assessment

Title:	Impact Assessment (IA)
Impact assessment of UK implementation regulations of the EU directive on settlement finality and financial collateral arrangements.	**IA No:**
Lead department or agency: HM Treasury	**Date:** 21/7/2010
Other departments or agencies:	**Stage:** Development/Options
	Source of intervention: EU
	Type of measure: Secondary legislation
	Contact for enquiries: Helena Forrest 0207 270 5694

Summary: Intervention and Options

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

In April 2008 the Commission decided to amend the Settlement Finality Directive(SFD) and the Financial Collateral Arrangements Directive (FCD), bringing both Directives in line with market and regulatory developments in the post-trading area. The SFD aimed to reduce the systemic risk associated with participation in payment and securities settlement systems and FCD sought to expand on the role of collateral in SFD. These directives provide a key underpinning for the systemic robustness of the financial markets.

The Government now has to implement the directive to meet the European deadline of 30 December 2010, and is proposing to do this by amending exisiting domestic legislation.

What are the policy objectives and the intended effects?

The Commission produced a report in 2005 on the operation of the SFD and in 2006 on the operation of the FCD. Both reports concluded that the Directives had proved a success. However, some improvements were identified. The objectives of the amending Directive are to increase the efficiency and safety of the EU financial market and ensure a level playing field among the relevant participants, principally by facilitating the use of credit claims as collateral, ensuring the stability of settlement systems, and enhancing legal certainty. The proposed UK implementation regulations brings this into effect so UK industry stakeholders can benefit from these changes and work more effectively in a changing post trade environment.

What policy options have been considered? Please justify preferred option (further details in Evidence Base)

1) To amend the Financial Markets and Insolvency Regulations (1999) and the Financial Collateral Arrangements (No.2) Regulations 2003 in order to comply with the European Directive 2009/44/EC.
2) Not to implement.

Option 1 is preferred in view of the EU requirement to adopt and publish the laws, regulations and administrative provisions, necessary to comply with this Directive by 30 December 2010. The Directive will apply from 30 June 2011.

When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?	It will be reviewed in 5 years
Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	Yes

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: ..... Date: 28/7/10

Summary: Analysis and Evidence

Policy Option 1

Description:

Impact of amending Financial Markets and Insolvency Regulations (1999) and the Financial Collateral Arrangements (No.2) Regulations 2003

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: 0.5bn	**High:** £35bn	**Best Estimate: £15bn**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0		0	**0**
High	£10m		0	**£10m**
Best Estimate	500k		0	**500k**

Description and scale of key monetised costs by 'main affected groups'

The principal monetised costs are likely to relate to system costs. We are seeking more information on these via the consultation process.

Other key non-monetised costs by 'main affected groups'

In the area of credit claims there could be indirect costs relating to any disadvantage suffered to creditors in the event of the insolvency of a company that has used credit claims as collateral.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	£0.5bn		TBC	**£0.5bn**
High	£35bn		TBC	**£35bn**
Best Estimate	£15bn		TBC	**£15bn**

Description and scale of key monetised benefits by 'main affected groups'

The European Commission has estimated the potential benefits for the euro area from bringing credit claims into the scope of the Financial Collateral Directive may amount to between Euro 3.5bn and Euro 263billion. The assumptions behind this estimate are outlined in the Commission's impact assessment on its proposals (link on p 3). A simple adjustment based on the relative size of UK and Eurozone GDP would suggest this figure might be E0.5bn to E35bn for the UK.

Other key non-monetised benefits by 'main affected groups'

The implementation of the Amending Directive should offer benefits from reduced legal risk, reduced risk of systemic disruption to the key financial architecture of London's markets and potentially reduced funding costs in the form of collateral savings and additional liquidity available to financial institutions.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

This is a consultation Impact Assessment. We have used the consultation to seek view from industry stakeholders can express a more detailed opinion on the costs and benefits of the UK implementation regulation.

Impact on admin burden (AB) (£m):			Impact on policy cost savings (£m):	In scope
New AB:	**AB savings:**	**Net:**	**Policy cost savings:**	Yes/No

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			United Kingdom		
From what date will the policy be implemented?			30/06/2011		
Which organisation(s) will enforce the policy?			UK courts/FSA		
What is the annual change in enforcement cost (£m)?			0		
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			No		
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:**	**Non-traded:**	
Does the proposal have an impact on competition?			No		
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			**Costs:**	**Benefits:**	
Annual cost (£m) per organisation (excl. Transition) (Constant Price)	**Micro**	**< 20**	**Small**	**Medium**	**Large**
Are any of these organisations exempt?	No	No	No	No	No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on…?	**Impact**	**Page ref within IA**
Statutory equality duties[1] Statutory Equality Duties Impact Test guidance	No	
Economic impacts		
Competition Competition Assessment Impact Test guidance	No	
Small firms Small Firms Impact Test guidance	No	
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	No	
Sustainable development Sustainable Development Impact Test guidance	No	

[1] Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

References

Include the links to relevant legislation and publications, such as public impact assessment of earlier stages (e.g. Consultation, Final, Enactment).

No.	Legislation or publication
1	EU impact assessment http://ec.europa.eu/internal_market/financial-markets/docs/proposal/impact_en.pdf
2	EU amending directive 2009/44/EC http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:146:0037:0043:EN:PDF
3	Settlement Finality Directive 98/26/EC http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:1998:166:0045:0050:EN:PDF
4	Financial Collateral Arrangements Directive 2002/47/EC http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2002:168:0043:0050:EN:PDF
5	The Financial Collateral Arrangements regulations 2003 Impact Assessment http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/d/idfca_ria_0104.pdf

Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

Annual profile of monetised costs and benefits* - (£m) constant prices

	Y_0	Y_1	Y_2	Y_3	Y_4	Y_5	Y_6	Y_7	Y_8	Y_9
Transition costs										
Annual recurring cost										
Total annual costs										
Transition benefits										
Annual recurring benefits										
Total annual benefits										

* For non-monetised benefits please see summary pages and main evidence base section

Microsoft Office
Excel Worksheet

Evidence Base (for summary sheets)

Background to the amending Directive (2009/44/EC)

On 6 May 2009 the European Parliament and Council adopted the Directive 2009/44/EC, which amends Directive 98/26/EC on settlement finality in payment and securities settlement systems, and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims. Member states have until 30 December 2010 to adopt and publish the laws, regulations and administrative provisions, necessary to comply with this Directive, which will apply from 30 June 2011.

The Settlement Finality Directive (98/26/EC) was adopted in 1998, in order to reduce the systemic risk associated with participation in payment and securities settlement systems. Since 1998, the post- trading environment has changed considerably. When the original SFD was passed, systems operated on an almost exclusively national and independent basis. However since then systems have become increasingly linked /interoperable. In 2005, the Commission published an evaluation report and concluded that certain parts of the Directive needed to be revisited and amended.

The Financial Collateral Arrangements Directive (2002/47/EC) sought to expand on the role of collateral from the Settlement Finality Directive. The objective was to achieve greater integration and cost –efficiency of European financial markets, by simplifying the collateral process, improving legal certainty in the use of collateral and reducing risks for market participants. In December 2006, the European Commission published an evaluation report, which concluded that the directive was largely working well, but that some aspects would benefit from revision.

Due to the close links between the Settlement Directive and the Financial Collateral Arrangements Directive, the Commission concluded that both directives should be amended together under Directive 2009/44/EC.

These implementation regulations seek to amend the UK Financial Markets and Insolvency Regulations 1999, and the Financial Collateral Arrangements (No.2) Regulations 2003 in order to comply with the European amending Directive 2009/44/EC.

Option 1 - To amend the Financial Markets and Insolvency Regulations (1999) and the Financial Collateral Arrangements (No.2) Regulations 2003 in order to comply with the European Directive 2009/44/EC.

Group of Measures 1: Introducing the concept of interoperable systems into law

Benefits: The Amending Directive changes various definitions and introduces various terms to ensure interoperable systems are brought into the regime with relevant protections clarified or extended where appropriate. At present, it is unclear whether interlinked systems fully benefit from the protections of the Settlement Finality Directive. By thus reducing the legal uncertainty surrounding the protections enjoyed by systems (e.g. clearing houses, settlement agents), which are linked to other systems, the risk of contagion in the financial system should be reduced. As such systems are vital for the proper functioning of financial markets, a contagion spreading through interlinked settlement systems could, in a worst-case scenario, cause widespread failures, leading to billions of pounds of costs.

As an illustration of the importance of maintaining the resilience of the systems designated under the SFD, we note that for example CHAPS handled an average daily value of £255 billion in 2009; representing almost 20% of annual UK GDP. Meanwhile the daily average value of cash moving through CREST was in the order of £908 billion in March 2010, including self-collateralising repo transactions.

Costs: These changes are clarifying ones and we have not identified any costs associated with them

Group of Measures 2: Providing clarity on calendar days and moments of entry

Benefits: The Directive clarifies that the SFD's protections apply to settlements that take place on the same business day as an insolvency is initiated, and obliges settlement systems to seek to co-ordinate their rules regarding the moment of entry and irrevocability of transfer orders. As with the measures outlined above, by reducing the legal uncertainty surrounding the protections enjoyed by systems (e.g.

clearing houses, settlement agents) which are linked to other systems, the risk of contagion in the financial system should be reduced. As such systems are vital for the proper functioning of financial markets, a contagion spreading through interlinked settlement systems could, in a worst case scenario, cause widespread, leading to billions of pounds of costs.

Costs: this could mean some implementation costs to industry, which we would not expect to be unduly burdensome. Systems which are interlinked will need to take steps to ensure that their rules governing the moment of entry and irrevocability of transfer orders are co-ordinated as far as possible. We are using the consultation process to seek more information from industry on the nature and scale of these costs, but have estimated them as between £0m and £10m in the meantime.

Group of Measures 3: Bringing credit claims into the scope of the FCD

Benefits: The Directive brings credit claims into the scope of the FCD's protections. The intention of this measure is to increase the pool of available collateral that banks can use. In principle, the availability of credit claims as a form of collateral could decrease the cost of funding for credit institutions, thus increasing lending with associated economic benefits. The Eurosystem has since 2007 accepted credit claims as collateral in its credit operations. Certain EU countries (such as Luxembourg) already include credit claims in the scope of their implementation of the FCD, meaning that implementation of the Amending Directive will put relevant UK entities on a level playing field with Entities in other EU jurisdictions. The European Commission has estimated (see reference 1 in list above) that the measure may benefit Euro area countries by E3.5bn to E263bn, in the form of collateral savings/additional liquidity available to financial institutions. (This estimate takes into account only the first-round effects and does not include any additional benefits that could come from financial institutions using this liquidity to fuel their businesses.) These potential benefits are of increased relevance to the UK in light of the Bank of England's announcement that it will accept credit claims as collateral for its Discount Window Facility. A simplistic adjustment based on the relative size of UK and Eurozone GDP would suggest this figure might be E0.5bn to E35bn for the UK. We will seek to revise this estimate in a rigorous way following the receipt of consultation reponses.

Costs: There may be costs among industry relating to implementing systems for handling credit claims in case such systems are not already in place, although it should be borne in mind that there is no obligation for industry to use credit claims as collateral. In addition it can be observed that in the extended regime, if a credit institution were to go bankrupt, any credit claims pledged as collateral would not be available to repay the institution's creditors, disadvantaging those creditors versus a situation in which they had a claim on the collateral.

<u>Option 2 – Not to implement</u>

Benefits: Existing legislation would stay the same for the industry. The costs described above would not accrue.

Costs: The risks described above would not be addressed. In addition the UK runs the risk of infraction proceedings being initiated by the European Commission if we do not meet the implementation date of 31 December 2010.

Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added where the Specific Impact Tests yield information relevant to an overall understanding of policy options.

Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

Basis of the review: [The basis of the review could be statutory (forming part of the legislation), it could be to review existing policy or there could be a political commitment to review]; Within 5 years of the implementation of the statutory instrument the Treasury will review the implementing regulations.
Review objective: [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?] To ensure that the regulations remain an appropriate method of implementing the Amending Directive.
Review approach and rationale: [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach] Treasury officials will seek views of relevant stakeholders, such as system operators, the Bank of England and the FSA.
Baseline: [The current (baseline) position against which the change introduced by the legislation can be measured]
Success criteria: [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives] The Treasury and stakeholders consider that the implementing regulations continue to satisfactorily implement the provisions of the amending directive.
Monitoring information arrangements: [Provide further details of the planned/existing arrangements in place that will allow a systematic collection systematic collection of monitoring information for future policy review] Treasury officials are in regular contact with affected stakeholders.
Reasons for not planning a PIR: [If there is no plan to do a PIR please provide reasons here]

HM Treasury contacts

This document can be found in full on our website at:
hm-treasury.gov.uk

If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 4558
Fax: 020 7270 4861

E-mail: public.enquiries@hm-treasury.gov.uk

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