EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2000 (DESIGNATED ACTIVITIES) (SUPERVISION AND ENFORCEMENT) REGULATIONS 2024

2024 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of His Majesty.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Declaration

2.1 Tulip Siddiq MP, Economic Secretary to the Treasury, confirms that this Explanatory Memorandum meets the required standard.

2.2 Catherine McCloskey, Deputy Director for Financial Services Strategy at HM Treasury, confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Will Mikola at HM Treasury, Telephone: 0786 606 0097 or email: will.mikola@hmtreasury.gov.uk can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 Part 5A (designated activities) of the Financial Services and Markets Act 2000 ('FSMA 2000') was inserted by the Financial Services and Markets Act 2023 ('FSMA 2023'). It allows HM Treasury to make regulations to 'designate' activities related to financial markets financial markets exchanges, instruments, products, or investments, and contains powers for the Financial Conduct Authority (FCA) to make rules and give directions relating to designated activities. The overall regulatory framework provided for by Part 5A is known as the designated activities regime (DAR).

4.2 This instrument enables the FCA to supervise and enforce rules that it makes under the DAR ('designated activity rules'). It allows the FCA to supervise designated activities by gathering information and launching investigations into persons carrying out designated activities, and to enforce its designated activity rules by publicly censuring or imposing financial penalties on persons that breach them. This instrument does this by extending the FCA's existing supervision and enforcement powers under FSMA 2000 so they can be used in relation to designated activities.

4.3 The instrument also sets out the procedures that will apply to the giving of directions by the FCA relating to designated activities. Directions allow the FCA to require a person or persons to do something or refrain from doing something.

Where does the legislation extend to, and apply?

4.4 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is the whole of the UK.

4.5 The territorial application of this instrument (that is, where the instrument produces a practical effect) is the whole of the UK.

5. Policy Context

What is being done and why?

5.1 Any business or person wishing to carry out regulated financial services activities, must become an 'authorised person' under FSMA 2000, subject to some exceptions. However, certain activities related to financial markets are carried out by a wide range of persons, many of whom are not typically considered to be financial services firms, and it would not be proportionate to make them become authorised persons.

5.2 This is why FSMA 2023 created the DAR as a new framework that would allow for the proportionate regulation of certain activities related to financial markets, without requiring the persons undertaking those activities to become authorised persons. The DAR allows HM Treasury, by regulations ('designated activity regulations'), to designate certain activities to be regulated by the FCA without the requirement for those carrying on the activities to become authorised persons.

5.3 The FCA needs appropriate powers to supervise the DAR and enforce compliance with designated activity rules. This instrument extends some of the FCA's existing supervision and enforcement powers in relation to authorised persons to designated activities.

5.4 In the first instance, the instrument applies this supervision and enforcement framework to the Consumer Composite Investments (Designated Activities) Regulations 2024 and the Short Selling Regulations 2024. If HM Treasury designates further activities in the future, then the intention is that the supervision and enforcement framework would also be extended to them.

What was the previous policy, how is this different?

5.5 The DAR was primarily designed to replace parts of assimilated EU law repealed by FSMA 2023, where it was not proportionate to require people conducting those activities to become authorised persons. Relevant activities, previously regulated by EU law, have been incorporated into UK law with a similar set of supervision and enforcement provisions as applied under EU law. This SI ensures that each new designated activity is supervised and enforced in a consistent way by the FCA.

5.6 This instrument will apply initially to the Consumer Composite Investments (Designated Activities) Regulations 2024 and the Short Selling Regulations 2024, which replace, in the UK, Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs) and Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps, respectively.

6. Legislative and Legal Context

How has the law changed?

6.1 Section 71O of FSMA 2000 provides a power of direction for the FCA in relation to designated activities. Designated activity regulations can prescribe the extent to which that power is available to the FCA in relation to a particular designated activity. Section 71O contains some basic procedural provisions about how directions are given or revoked, and gives HM Treasury the power to further specify procedure through regulations. This instrument inserts a new Chapter 2 into Part 5A of FSMA 2000, which sets out the procedures that will apply to the power of direction. Those procedures reflect, in various respects, the procedures attached to similar powers already available to the FCA in respect of authorised persons.

6.2 FSMA 2000 contains a range of supervisory and enforcement powers for the FCA, including those in Part 11 (information gathering and investigations) and Part 14 (disciplinary measures), but many of these are available only in respect of authorised persons or certain other categories of regulated person. This instrument amends FSMA 2000 to extend powers from Parts 11 and 14 so that they are available to the FCA in respect of persons carrying on designated activities.

6.3 The instrument adds new definitions of "relevant designated activity", "relevant Part 5A requirement" and "relevant Part 5A direction" and the scope of each is determined by a new Schedule 6C. For the time being, the entries in Schedule 6C relate only to the Consumer Composite Investments (Designated Activities) Regulations 2024 and the Short Selling Regulations 2024. As and when HM Treasury makes new designated activity regulations, the intention is that those regulations will be brought into the supervisory and enforcement framework by adding to the entries in Schedule 6C.

Why was this approach taken to change the law?

6.4 This instrument provides greater consistency for the FCA and those subject to FCA rules. The alternative would be creating a specific enforcement regime for each activity. This would make it more difficult for the FCA to consistently supervise activities and enforce rules, and would come with additional costs for firms in determining and adapting to the enforcement framework for any activity they wished to carry out.

6.5 The instrument amends FSMA 2000, rather than making freestanding provision, in order to reduce the number of different instruments firms need to look at in order to understand the supervisory and regulatory framework to which a designated activity is subject.

7. Consultation

Summary of consultation outcome and methodology

7.1 HM Treasury did not formally consult on the instrument, although it has consulted on draft versions of the Consumer Composite Investments (Designated Activities) Regulations 2024 and the Short Selling Regulations 2024. As this instrument creates a supervision and enforcement regime based on the regime which already exists for regulated activities in FSMA 2000, HM Treasury did not consider public consultation to be appropriate.

8. Applicable Guidance

8.1 No guidance accompanies this instrument.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A full Impact Assessment has not been prepared for this instrument because it only enables the effective supervision of, and enforcement relating to, designated activities. The impact on firms from the regulation of a designated activity will flow principally from the FCA's approach to supervision and enforcement of the relevant activity. This is anticipated to be specific to each designated activity regulated, and would be included as part of the impact assessment for any instrument that designates an activity. The government does not generally assess successful enforcement action - such as fines levied after a breach of rules - as a cost to firms.

Impact on businesses, charities and voluntary bodies

9.2 There is no, or no significant, impact on business, charities or voluntary bodies. The instrument only enables the effective supervision of, and enforcement relating to, designated activities and the impact of this supervision and enforcement will depend on how often the FCA determines that it needs to exercise the relevant powers.

9.3 In the first instance, these will be the powers the FCA has by virtue of the Consumer Composite Investments (Designated Activities) Regulations 2024 and the Short Selling Regulations 2024. These regulations replace EU-inherited regimes. They each have their own impact assessments that consider the costs of the new, UK-specific regimes.

9.4 The legislation impacts small or micro businesses in the same way as it impacts other businesses.

9.5 For the same reasons, there is no, or no significant, impact on the public sector because the instrument only enables the effective supervision of, and enforcement relating to, designated activities.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The effect of supervision and enforcement of each regime for a designated activity will be reviewed as part of any review, statutory or otherwise, of the regime itself.

10.2 The instrument does not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015, Tulip Siddiq MP, Economic Secretary to the Treasury, has made the following statement:

"It is not proportionate to include a review clause in this instrument because it does not have significant impacts on business."

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 There are interdependencies between certain provisions of this instrument, the Consumer Composite Investments (Designated Activities) Regulations 2024 and the Short Selling Regulations 2024. Those interdependencies, and the steps being taken to manage them, are described in more detail in paragraphs 10.2 to 10.5.

11.2 This instrument – specifically some of the amendments to FSMA 2000 made by this instrument – refers expressly to the Short Selling Regulations 2024 in order to apply those amendments to the regime for the regulation of designated activities relating to short selling. The amendments also refer expressly to the Consumer Composite Investments (Designated Activities) Regulations 2024 for similar reasons.

11.3 The Short Selling Regulations 2024 in turn refer expressly to some of the new material inserted into FSMA 2000 by this instrument. The Short Selling Regulations 2024 rely in part on powers in Part 5A of FSMA 2000 to specify certain activities relating to short selling as designated activities and to make further provision about such activities; and they rely in part on section 4 of FSMA 2023, which permits HM Treasury to make provision restating and modifying assimilated law revoked by section 1 of, and Schedule 1 to, FSMA 2023. HM Treasury has in this case exercised this power in relation to Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps.

11.4 The section 4 restatement portion of the Short Selling Regulations 2024 includes provision applying a number of provisions of FSMA 2000 (with modifications where appropriate) in order to deal with matters such as enforcement by the FCA. In the case of the Part 5A portion of the Short Selling Regulations 2024, equivalent matters will be dealt with by the amendments which this instrument makes to FSMA 2000. So that the FCA has consistent powers for enforcement activity relating to both portions of the Short Selling Regulations 2024, those Regulations expressly apply some of the new material inserted into FSMA 2000 by this instrument.

11.5 The Short Selling Regulations 2024 have been laid in draft at the same time as this instrument; the Consumer Composite Investments (Designated Activities) Regulations 2024 were laid in draft on 10 October 2024. Given that this instrument relies on those other two sets of Regulations, HM Treasury will make this instrument only if Parliament approves those other Regulations. Moreover, given that the Short Selling Regulations 2024 rely on this instrument, HM Treasury will make the Short Selling Regulations 2024 only if Parliament approves this instrument. HM Treasury will make this instrument and the Short Selling Regulations 2024 on the same day so that they come into force (in the case of this instrument, in full, and in the case of the Short Selling Regulations, in part) at the same time at the beginning of the day after that on which they are made.

12. European Convention on Human Rights

12.1 The Economic Secretary has made the following statement regarding Human Rights:

"In my view the provisions of the Financial Services and Markets Act 2000 (Designated Activities) (Supervision and Enforcement) Regulations 2024 are compatible with the Convention rights."

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts"). It does however relate to the withdrawal of the United Kingdom from the European Union because the regimes that the DAR allows for the replacement of derive from assimilated law in financial services, which is repealed by FSMA 2023.