
EXPLANATORY NOTE

(This note is not part of the Order)

This Order defines the circumstances in which ring-fenced bodies will be able to deal with investments as principal by providing for exceptions to the excluded activity set out in section 142D of the Financial Services and Markets Act 2000 in relation to the management by the ring-fenced body of its own risks or of its liquid assets or the provision of derivatives to its clients. The Order also imposes prohibitions on ring-fenced bodies under section 142E, which (with the exceptions provided for) limit the way in which a ring-fenced body may have access to clearing and settlement services provided by a recognised inter-bank payment system, restrict the exposures a ring-fenced body may have to relevant financial institutions, and ensure that a ring-fenced body may not have a subsidiary or branch in any country outside the EEA (other than operational subsidiaries which do not provide banking services).

Article 1 defines the terms used in the Order.

Article 2 defines relevant financial institution for the purposes of the Order.

Article 3 defines terms used in connection with securitisation companies and structured finance vehicles for the purposes of the Order.

Part 2 provides for an additional excluded activity (commodities trading), and sets out the circumstances in which ring-fenced bodies may engage in dealing in investments as principal, and commodities trading, as exceptions to the excluded activities.

Article 4 provides for additional circumstances in which the activity of dealing in investments as principal will be an excluded activity, clarifying the relationship between the excluded activity and the regulated activity of dealing in investments as principal. Under section 142D(2) the regulated activity of dealing in investments as principal, defined in article 14 of the Financial Services and Markets Act (Regulated Activities) Order 2001 (“the Regulated Activities Order”) (and subject to a number of exceptions which are set out in articles 15 to 20 of that Order) is an excluded activity. Article 4 ensures that dealing in investments as principal which falls within the scope of articles 15, 19 or 20 of the Regulated Activities Order 2001, and is not therefore a regulated activity, is made an excluded activity. Dealing in investments as principal which falls within the exemptions from the regulated activity set out in articles 17, 18 or 18A of the Regulated Activities Order 2001 will remain outside the scope of the excluded activity.

Article 5 provides that a ring-fenced body may not engage in commodities trading except in the circumstances set out in that article.

Article 6 provides for exceptions to the excluded activity of dealing with an investment as principal where the ring-fenced body is managing the risks associated with its business, including for example its interest rate risk, exchange rate risk, or liquidity risk (paragraphs (1) and (2)). The ring-fenced body is also permitted to deal in liquid assets or to provide collateral required for derivative transactions entered into as part of its risk management (paragraph (3)). Article 6(4) further permits a ring-fenced body to acquire investments in exchange for a loan write-off (subparagraph (a)), and to acquire debentures issued by itself, one of its subsidiaries or its parent undertaking (subparagraph (b)) (no exception is necessary to permit the ring-fenced body to deal with its own shares, as, by virtue of article 18A of the Regulated Activities Order 2001, this is not an excluded activity). It may also acquire debentures directly from an issuer where the issuer chooses to structure its borrowing in this way (paragraph (4)(c)), and to acquire shares in subsidiaries or companies in which it has a participating interest (paragraph (4)(d)). Paragraph (5) sets out the circumstances in which investments acquired under these provisions may be sold (debentures acquired under paragraph (4)(c) may not be sold – the ring-fenced body must hold them to maturity). Finally, Article 6(6) permits the ring-fenced body to use investments as security.

Changes to legislation: *There are currently no known outstanding effects for the The Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014. (See end of Document for details)*

Article 7 permits a ring-fenced body to deal in investments as principal where the other party to the transaction is a structured finance vehicle sponsored by the ring-fenced body which satisfies the conditions set out in article 3(2). The ring-fenced body may also buy debentures issued by such a structured finance vehicle or by a conduit vehicle of the ring-fenced body.

Article 8 provides for an exception to the excluded activities of dealing in investments as principal and commodities trading where the ring-fenced body is entering into a transaction with a central bank or a wholly owned subsidiary of a central bank.

Articles 9 to 12 set out the conditions which must be satisfied by a ring-fenced body which wishes to deal in derivative instruments with its account holders.

Article 10 permits a ring-fenced body to sell currency and interest swaps, forward contracts (including futures) relating to currency, commodities or other property to its account holders.

Article 11 permits a ring-fenced body to sell certain options to its account holders, including interest rate caps and floors, and interest rate swaptions.

Article 12 sets out the conditions which must be satisfied by derivative transactions between a ring-fenced body and its account holders.

Part 3 imposes a number of prohibitions on ring-fenced bodies, and provides for exemptions to those prohibitions.

Article 13 sets out the circumstances in which a ring-fenced body may use services provided through an inter-bank payment system indirectly by an intermediary.

Articles 14 to 19 set out the circumstances in which a ring-fenced body is permitted to have an exposure to a relevant financial institution.

Article 14 permits exposures arising in relation to transactions entered into by the ring-fenced body for risk management purposes, intra-group transactions and payments exposures.

Article 15 permits exposures arising in relation to trade finance.

Article 16 permits a ring-fenced body to incur exposures to its own sponsored structured finance vehicle (which must satisfy the conditions set out in article 3(2)).

Article 17 permits a ring-fenced body to incur exposures for the purpose of conduit lending to the special purpose vehicle of an undertaking which is not itself a financial institution or to the ring-fenced body's own special purpose vehicle.

Article 18 permits a ring-fenced body incur exposures arising in the course of repo transactions.

Article 19 permits a ring-fenced body to incur exposures to relevant financial institutions which are ancillary to the provision of the core services by the ring-fenced body.

Article 20 prohibits a ring-fenced body from having a branch or a subsidiary (other than a subsidiary which does not carry out any activities which would be regulated under the Financial Services and Markets Act 2000 if they were carried on in the UK) in a country or territory outside the EEA.

Article 21 makes transitional provision to ensure that a ring-fenced body is not required to divest itself of investments which have less than two years to maturity when this order comes into force. An Impact Assessment of the effect of the Financial Services (Banking Reform) Act 2013, and the secondary legislation to be made under it (including this Order) on the costs of business and the voluntary sector has been prepared and is available on HM Treasury's website (www.gov.uk/treasury) or from HM Treasury, 1 Horse Guards Road, London SW1A 2HQ and is annexed to the Explanatory Memorandum for this Order.

Changes to legislation:

There are currently no known outstanding effects for the The Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014.