

Detailed Response to HM Treasury Questions

The detailed response to the questions raised by HM Treasury is provided below. The key broad questions identified by HM Treasury within this process are highlighted in bold.

Reference	Question	Response
3a	Do you have any general comments about types of market-based approaches to promoting order in the financial system during major operational disruption?	All exchange contracts are subject to exchange rules and contain provision for 'force majeure' circumstances. This level of contractual protection is generally applied in the UK as a matter of course due to the maturity of our markets and the attendant operational threats continually endured. Standard OTC contracts usually contain reference to extraordinary market events to ensure flexibility in the event of a disaster.
3b	Is there more that could usefully be done by the private sector to strengthen the contingency provisions in contracts and other legal instruments? Is there a role for the authorities in assisting with this?	There is always more that could be done. The authorities can play a central role, providing confidential co-ordination and review functions and can help to arbitrate and develop industry best practice standards. The authorities can further assist by 'encouraging' and 'leading' market practice changes.
3c	Is there more that could usefully be done by the private sector to strengthen market cooperation? Is there a role for the authorities in assisting with this?	<p>There is always scope for strengthening market cooperation. These things are probably easier achieved through accepted market practice or rule changes. Industry fora such as LIBA and the Exchange's Market Rules Advisory Group would be useful for driving behaviour changes, agreeing new processes and increasing cooperation.</p> <p>Again, the authorities can assist by 'encouraging' and 'leading' market practice changes.</p> <p>Developing standards for contingency planning and business continuity arrangements would be helpful. Having accreditation against minimum resiliency and operational standards would provide tangible measurement criteria and improve market resilience and confidence. The FSA could work with the British Standards Institute to develop standards applicable to the financial markets.</p> <p>Cross-market testing should be undertaken at regular intervals. There is a role for the authorities to provide central leadership for such events, providing simulation test scripts and encouraging the appropriate level of participation from the relevant parties.</p> <p>September 11th was characterised by considerable goodwill and a spirit of cooperation and support amongst financial market practitioners. It may be helpful to codify behaviours and responses to provide a supportive environment in times of operational disruption. Again, this may be an area the FSA could provide some leadership and facilitate development of such behavioural standards in consultation with the market.</p>

Reference	Question	Response
4a	<p>In principle, would it be useful to have new legislation to help promote order in the financial system in the face of major operational disruption?</p>	<p>Clear and unambiguous legislation would provide a level of certainty which would be helpful and would introduce a level of comfort across the markets that doesn't currently exist.</p> <p>Any legislation should give recognised bodies the same level of protection as currently provided under the Financial Services and Markets Act (2000) which defines recognition requirements under which RIE and RCH status is governed.</p>
4b	<p>Have you any comments on: how new legislation might address risks; the possible disadvantages and limitations of new legislation; and the general constraints on the use of new legislation?</p>	<p>Constraints on use could be achieved by limiting any invocation of powers to being on a request only basis by recognised bodies.</p> <p>There should be no constraint on individual recognised bodies acting unilaterally within the operational powers currently available under RIE or RCH status.</p>
4c	<p>If new legislation were to be sought, are the suspension and direction powers the right choices? Are there any other types of legislation that might be useful to help promote order in the financial system?</p>	<p>The suspension and direction powers provide high level mechanisms to deal with any eventuality. It should not be necessary to introduce any further mechanisms.</p> <p>The circumstances requiring action under the proposed powers will require further detail in any secondary legislation.</p>
5a	<p>Have you any comments on the possible approaches to making secondary legislation/administrative directions, including who should exercise this function, the attractiveness of potential fallback routes for making the secondary legislation/administrative directions, accountability to Parliament and modification of secondary legislation/administrative directions?</p>	<p>Authority to exercise these powers should rest with Treasury ministers or other government ministers as defined in succession plans and as communicated via the FSA/BofE as appropriate.</p> <p>Any secondary legislation/administrative directions should only be initiated following consultation with authorized personnel from the affected recognised bodies.</p> <p>Any modification to secondary legislation/administrative directions also needs to be undertaken via consultation to ensure operational impact and communication arrangements are properly considered.</p> <p>Communication processes need to be defined and should include appropriate levels of resilience to ensure market-wide notification of directions is effective.</p> <p>It is recommended that draft secondary legislation is prepared to outline the scenarios that are envisaged and to assist the markets in disaster recovery planning and testing.</p>

Reference	Question	Response
5b	Should primary legislation include further conditions for use of its powers (beyond the basis for use being major operational disruption and not a purely financial crisis)? If so, what?	<p>Primary legislation should only enable use of these powers for events causing major operational disruption. Any other arrangement would reduce the clarity and confidence the legislation could provide to the market.</p> <p>A more prescriptive definition of 'major operational disruption' would be helpful.</p>
5c	Would you support specification in the primary legislation of a maximum time period for the duration of powers? If so, how, and for what period?	<p>Defining a maximum period in the primary legislation would provide some comfort to those entering into contracts that any temporary powers would be limited to a finite period. It is unlikely that any powers would need to be invoked for longer than two weeks which would therefore seem to be a sensible maximum time period.</p>
5d	If the powers were adopted, do you agree they should affect actions in the UK (rather than actions governed by UK law)?	<p>Cross-border trading, clearing and settlement considerations are complex, further consultation and analysis is needed before this question can be answered. Other jurisdictions should be encouraged to develop their own complementary arrangements and legislation.</p> <p>It would be better for the proposed legislation to cover contracts under UK law only, though this creates problems of its own. For instance, if a member firm of the Exchange's trades on SETS on behalf of a German customer, in two back-to-back contracts, one subject to English law and the other subject to German law. The English contract is suspended, but the German contract is not.</p> <p>It is quite possible for a contract to be entered into between a German and Spanish firm on a UK RIE's trading system, which is novated into a contract with a UK clearing house and settled in both Euroclear Brussels and the Swiss SIS. Geographical location can only increase uncertainty in today's systems of cross-border electronic trading and clearing.</p> <p>These international considerations and cross-border issues should be more fully explored before any legislation is proposed.</p> <p>Certain UK based exchanges host systems and provide support services to overseas exchanges and any new legislation should not affect these arrangements.</p> <p>Any invocation of the powers affecting contracts under UK law will result in liquidity moving to other markets as the larger market participants are global players with alternate market access facilities. This may have a longer term impact on UK financial markets and it is therefore important that use of the powers is limited.</p>

Reference	Question	Response
5e	If the Government seeks new legislation, should it allow the use of powers following major operational disruption affecting a non-UK major financial centre?	Further analysis should be undertaken to determine the likely impact on UK financial systems following major operational disruption in a non-UK major financial centre. Our initial view is that existing rights and obligations of recognised bodies and market practice contractual contingencies would be sufficient to maintain domestic market stability and in any event any powers should be restricted to those contracts affected by major operation disruption overseas.
6a	Which wholesale market obligations should be included in a suspension power's maximum scope? Please draw attention to any particular issues that might arise (e.g. regarding proprietary rights).	<i>The Exchange has no particular view on this issue, a response would be more appropriate from the affected market sector.</i>
6b	Should retail obligations be included in a suspension power's maximum scope?	Yes. It is clear that suspension powers could affect retail contract obligations and the proposed powers would provide a level of comfort to the wider retail market.
6c	If a distinction should be made between retail and wholesale obligations, how should the line be drawn?	It is not advisable to have different rules for different market factions. It is difficult to differentiate between the functions, particularly within equity markets. Some participants will operate in dual roles. It will be very difficult to administer rules and arbitrate disputes arising from interpretation of obligation changes. This will reduce the level of clarity and transparency the proposals would otherwise deliver.
6d	Which insurance contracts, if any, should be included in a suspension power's maximum scope?	<i>The Exchange has no particular view on this issue, a response would be more appropriate from the affected market sector.</i>
6e	Are there any other types of obligations suitable for inclusion in a suspension power's maximum scope?	Any potential variable (payment, delivery terms etc.) within a contract should be included within the scope.
6f	Should obligations governed by foreign law, but falling to be performed in the UK, be subject to the suspension power? How important is this? How might such an effect be achieved?	No. It is difficult to see how such a power can be implemented without corresponding legislation in the governing jurisdiction.

Reference	Question	Response
6g	Should a suspension order only be able to apply to all the obligations arising from a contract? Or are there cases for which it could be preferable to suspend some obligations arising from a contract, but not others?	There may be circumstances which cause some obligations to be difficult to fulfill such as payment or delivery. It should be possible to apply the suspension powers accordingly.
6h	Should a suspension power only be able to affect obligations which could not be fulfilled as a result of the disruption?	Ideally yes. Normal operations should continue where possible and obligations fulfilled. The suspension powers should only provide a period of grace where events beyond the control of a specific party cause that party to be unable to meet those obligations.
6i	Are there any other restrictions that should apply to how a suspension power could be used?	To prevent potential misuse and inappropriate requests for suspension from specific market interest groups, suspension powers should only be used upon request from recognised bodies or the FSA.
6j	Have you any comments about consequential effects of a suspension power?	Consequential reimbursement should include consideration of time value for money, storage costs etc. A legislative framework for this would be useful. However, the finalisation of any terms is best left to recognised bodies. OTC contracts will usually take their lead from the terms determined by recognised bodies.
6k	After a suspension period should obligations return immediately, as soon as practically possible, or is some other approach preferable?	Immediate return to normal obligations is preferable and would improve clarity and certainty during any application of the powers.
6l	Do you support the idea of a suspension power, subject to the constraints of paragraph 6.28?	In principle yes. In practice it requires the agreement, implementation and maintenance of clear and detailed communication and authorisation lines.
7a	Should recognised bodies be within the maximum scope of a direction power?	Yes.
7b	Should payment systems be within the maximum scope of the direction power? If so, which?	Yes. All systems governed under UK law.
7c	Should functions of institutions that are similar to the functions of recognised bodies and payment systems be within the maximum scope of a direction power?	Yes. Such functions and institutions should be recognised to assist the clarity and transparency of the powers.

Reference	Question	Response
7d	What actions should directions to infrastructure be able to order? Should directions themselves effect changes, where appropriate, or only be able to require infrastructure to take actions?	Actions should not be defined by Government. It is sufficient to provide direction and then allow the relevant bodies to implement the direction in the appropriate manner. Any resulting action will need to be undertaken in accordance with defined operational procedures, market practices/standards and in line with any relevant recognition requirements.
7e	Have you any comments about consequential effects of a direction power?	<p>Any legislation should supplement the existing powers of an RIE or RCH and provide, at a minimum, the same level of legal protection as the Financial Services and Markets Act (2000).</p> <p>Recognised bodies should not be inhibited from taking unilateral action in line with recognition requirements governing RIE or RCH status ahead of or pending the implementation of direction powers during any operational disruption.</p>
7f	Do you support the idea of a direction power, subject to the constraints of paragraph 7.29?	<p>In principle yes. There needs to be much more clarity around the circumstances under which such powers would be used. In particular, a more explicit definition of ‘major operational disruption’ would improve the clarity and certainty surrounding the potential usage of such powers.</p> <p>The introduction of new powers should not dilute the current independence of registered bodies and they should continue to be empowered to make unilateral decisions in line with recognition requirements governing RIE and RCH status.</p>
Aa	Have you any comments about the usefulness of the Banking and Financial Dealings Act 1971 powers in responding to major operational disruption?	The Act is outdated. Many contracts are now settled on UK bank holidays.

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Ba	Have you any comments on this draft Regulatory Impact Assessment?	<p data-bbox="1057 165 1989 225">This paper does not describe any gaps in the current arrangements that will be resolved through the implementation of new legislation.</p> <p data-bbox="1057 253 2004 528">This consultation process does not provide sufficient time for the current statutory powers and general legislative framework to be properly analysed. It is therefore felt that there is insufficient detailed knowledge to make informed decisions about the appropriateness of these legislative proposals. A formally led market-wide consultation process undertaking a full analysis of current domestic and international powers should be undertaken before determining the gaps and drafting the relevant legislation to deal with major operational disruption. This detailed analysis should be led by HMT and supported by BofE and FSA with input from all relevant market participants.</p> <p data-bbox="1057 560 2011 802">The paper does not describe any legislative framework adopted in other countries. The international nature of financial markets with cross-border trading and settlement will make any new legislation difficult to implement without corresponding arrangements and provision in other jurisdictions. A more detailed analysis of current arrangements (laws and market practices) to determine requirements for the international aspects of financial market operations is advisable. Encouraging reciprocal and complementary legislation in other jurisdictions is desirable before implementing new UK based legislation.</p> <p data-bbox="1057 834 2000 1043">Financial market operations are heavily dependent on telecommunications and general utility service provision. There is a UK vulnerability to utility services such as water, electricity etc. There is a financial market vulnerability to national and international telecommunications service provision. The resilience and recoverability of utility and telecommunications services need to get more attention and should feature in plans for improving the resilience of financial markets during major operational disruption.</p>