



Financial Services Authority

# Guidance to Applicants: Designated Systems under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999

December 1999

# Contents

Introduction	3
Application process	4
Provision of information by applicants	4
Considering an application for designation	5
Fees	7
Procedure for grant or refusal of designation	7
Provision of information by designated systems	8
Revocation of designation	8
Annex: Schedule of requirements for designation of system	10

Enquiries should be made to:

Mike O'Hagan  
Markets & Exchanges Division  
The Financial Services Authority  
25 The North Colonnade  
Canary Wharf  
London E14 5HS

Telephone: 020 7676 5850  
Fax: 020 7676 9729  
E-mail: [mike.o'hagan@fsa.gov.uk](mailto:mike.o'hagan@fsa.gov.uk)

# Guidance to Applicants: Designated Systems under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999

## Introduction

- 1 This paper sets out the FSA's guidance to applicants for designation under Part II of the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 ('SF regulations') and on the approach it will follow in processing and considering applications. The FSA is issuing this guidance under the powers set out in Regulation 12 of the SF regulations in order to assist those persons seeking designation. The guidance is not itself designed either to be exhaustive or to have the character of rules or regulations. Ultimately, only the courts can give legally binding interpretations of the regulations.
- 2 Any body corporate or unincorporated association may apply for an order designating it, or any system of which it is the operator, to be a system under the SF regulations. Applications should be made to the FSA, as designating authority, where the system:
  - is, or the operator of which is, a UK recognised investment exchange ('RIE') or a UK recognised clearing house ('RCH') under the Financial Services Act 1986;
  - is, or the operator of which is, a listed person within the meaning of the Financial Markets and Insolvency (Money Market) Regulations 1995; or
  - is a system through which securities transfer orders are effected (whether or not payment transfer orders are also effected through that system).
- 3 Under the SF regulations, securities are defined as instruments referred to in section B of the Annex to Council Directive on investment services in the securities field (93/22/EEC).
- 4 In cases other than those described above, applications should be made to the Bank of England (the 'Bank').
- 5 Prospective applicants will need to ensure that they have the necessary regulatory authority, such as authorisation or exemption, to undertake any activity they intend to perform if that activity would constitute the carrying on of investment business in the UK or would involve them in accepting deposits in the UK in the course of carrying on a deposit-taking business.

## Application process

- 6 A prospective applicant should contact the Markets and Exchanges Division at the FSA at an early stage for advice on the preparation, timetabling and practical aspects of an application. It is important, if an application is to be processed smoothly and in a reasonable time, that it is well prepared and is clear and comprehensive.
- 7 The FSA will keep the applicant informed of the progress of the application. It may be necessary to ask the applicant to provide additional information or to have information verified.
- 8 Where an application has been made to the FSA in relation to a system through which both securities and payment transfer orders are effected, the FSA will consult the Bank before deciding whether to make the designation order. The FSA may provide the Bank with information and material received from the applicant.

## Provision of information by applicants

- 9 There is no standard application form. Every application must be in writing and:
  - include copies of the rules of the system to which the application relates and any guidance relating to that system;
  - include the information, evidence and explanatory material necessary to demonstrate to the FSA that the designation requirements will be met; and
  - be accompanied by any necessary supporting documentation.
- 10 The information, evidence and explanatory information the FSA is likely to need includes:
  - details of the applicant's constitution, structure, ownership and management;
  - details of the design and function of the system, including details specifying the point at which a transfer order takes effect as having been entered into the system and of the point after which a transfer order may not be revoked by a participant or any other party;
  - copies of the last three annual reports and accounts (with any auditor's reports) and, for the current financial year, quarterly financial statements and management accounts of the applicant;
  - details of the applicant's arrangements or proposed arrangements for monitoring and enforcing compliance with the rules of the system;

- details of the applicant's arrangements or proposed arrangements for co-operating with the FSA and other appropriate authorities, including draft memoranda of understanding or letters;
  - the default arrangements of the system, including, if relevant, an explanation of how they interact with the default arrangements or rules of any other system or RIE or RCH; and
  - an explanation of how each of the requirements set out in the Schedule to the SF regulations is satisfied for the system.
- 11 Applicants which are UK RIEs or UK RCHs may not be required to provide information to the FSA which they have already provided, if that information has not changed since it was previously provided.

## Considering an application for designation

### Criteria for designation

- 12 The FSA may make a designation order declaring a system to be a designated system for the purposes of the SF regulations where:
- an application for designation has been duly made in respect of that system;
  - the applicant has paid the application fee (which is discussed below); and
  - the FSA is satisfied that the requirements of the Schedule to the SF regulations are satisfied with respect to that system.

### Schedule to the SF regulations

- 13 A copy of the Schedule to the SF regulations is appended.
- 14 UK RIEs and UK RCHs are deemed to satisfy the requirements in paragraphs 2 and 3 of the Schedule.
- 15 Among other things, the Schedule requires that the system to be designated '...must be a system through which transfer orders are effected.' (A 'transfer order' may be a 'securities transfer order' or a 'payment transfer order', as defined in the SF regulations.)
- 16 The FSA considers that transfer orders for these purposes will take the form of unequivocal instructions authorising the transfer of securities or payments in the manner described in the definition of 'transfer order' in the SF regulations. Transfer orders must commit the person making them, in the sense that under the rules of the system the instructions they comprise may legitimately be followed by the system or person to whom they are made. A transfer order may, however, be made subject to conditions (such as being matched with

another transfer order), if that condition does not detract from the unequivocal nature of the instruction.

- 17 A system through which transfer orders are effected need not necessarily complete the transfers to which those transfer orders relate (such as by final delivery of the underlying property), provided that the system effects the transfer of some legal right or interest in relation to the securities or payments to which the transfer orders relate.
- 18 Potential applicants will also note the requirement in paragraph 5 of the Schedule to the SF regulations. This prescribes that, to be designated, systems must make specific provisions in their rules. In particular, a system's rules must:
  - specify the point at which a transfer order takes effect as having been entered into the system;
  - specify the point at which a transfer order becomes irrevocable; and
  - prohibit the revocation of a transfer order (by the person making it or by any other party) from that point.
- 19 The FSA considers that transfer orders may be entered into a system by a participant or generated by the system under its rules. In either case, the rules of that system should specify every point at which an instruction is to take effect as a transfer order entered into the system.
- 20 The FSA recognises that under the SF regulations it is not a prescribed quality of a transfer order that it should be irrevocable at the point of entry into the system. However, a system which is capable of designation must specify in its rules the point at which such transfer orders are to become irrevocable. The FSA will review carefully these rules and their effect.
- 21 The FSA will expect the rules provided by an applicant to include all the specific rules referred to above and to specify which instructions within it are 'transfer orders' for these purposes.

### Systemic risk

- 22 The SF regulations require the FSA, as designating authority, to have regard to systemic risks in determining whether to make a designation order. The FSA will therefore have regard to these risks along with all other relevant matters when considering whether to make a designation order.
- 23 In addition, the FSA may make a designation order in respect of a system which falls within one of the specific cases described below, only where it is satisfied that designation is required on grounds of systemic risk:
  - any system in which only two institutions participate; and

- any system through which orders relating to financial instruments other than securities are effected and which is primarily a system through which securities transfer orders are effected.
- 24 The SF regulations enable the FSA to treat certain undertakings which participate in systems as institutions where:
- at least three institutions, which are not such undertakings, participate;
  - the system is one through which securities transfer orders are effected; and
  - it considers such treatment is required on grounds of systemic risk.
- 25 The FSA may treat an indirect participant as a participant, or a class of indirect participants as participants, where it considers this is required on grounds of systemic risk.

## Fees

- 26 An applicant is required to pay an initial fee to the FSA before the FSA decides whether to grant or refuse an application for designation. The initial designation fee will not exceed the costs incurred, or likely to be incurred, by the FSA in considering the application. The FSA will require an applicant to pay an amount of £8,000 at the time the application is made and to pay any balance of the costs incurred in considering the application before the FSA makes its decision to grant or refuse designation.
- 27 In addition to the initial designation fee, the FSA will charge designated systems a periodical fee which represents the costs likely to be incurred in satisfying itself that the designated system continues to comply with the designation requirements and any other obligations under the SF regulations. The FSA has decided that, initially, it will charge designated systems a periodical fee of £2,000 per annum. Any difference between the actual costs incurred by the FSA and the periodical fee paid will be dealt with in the following year, after the FSA's annual accounts have been audited, by an adjustment to the periodical fee payable by a designated system in that following year.

## Procedure for grant or refusal of designation

- 28 When the FSA has considered an application and has received the initial fee, the FSA will decide whether to make a designation order. If the FSA is unlikely to grant a designation order, it would expect to:
- discuss its concerns with the applicant as early as possible; and

- hear representations from the applicant, its participants or any other persons likely to be affected. The FSA will not normally consider oral representations without first receiving written representations from the person concerned.
- 29 After considering any representations made, the FSA will decide whether to make an order and give written notice to the applicant.
- 30 The designation order will state the date on which the order takes effect.
- 31 If the FSA decides not to make a designation order, it will provide the applicant with a written notice of the reasons for its decision, including those that may be based on its consultation with the Bank or other experts.

### **Provision of information by designated systems**

- 32 On being declared a designated system, a system is required to provide in writing to the FSA a list of its participants and to give written notice within 7 days to the FSA of any amendment to the list.
- 33 If a designated system amends, revokes or adds to its rules or its guidance, it is required to give written notice to the FSA within 14 days of the amendment, revocation or addition. A designated system must give 14 days advance notice of any proposal to amend, revoke or add to its default arrangements.
- 34 The FSA may also require a designated system to provide additional information to the FSA to assist it in performing its functions under the SF regulations, including information relevant to the question of whether that system continues to comply with the designation requirements.
- 35 A designated system is not required to give any notice or provide information to the FSA under the SF regulations which it has given or provided in order to comply with other requirements such as those imposed by or under section 41 of the Financial Services Act 1986 (notification requirements).

### **Revocation of designation**

- 36 A designation order may be revoked by the FSA by a further order if at any time it appears to the FSA:
- that any requirement of the Schedule is not satisfied in the case of the system to which the designation order relates; or
  - that the system has failed to comply with any obligation to which it is subject by virtue of the SF regulations.
- 37 Before revoking a designation order, the FSA will normally:

- give written notice to the designated system of its intention to revoke the designation order and the reasons for its decision;
- take steps that it considers reasonably practicable for bringing the notice to the attention of the participants of the designated system; and
- publish the notice in such a manner as it thinks appropriate for bringing it to the attention of any other persons likely to be affected.

38 The designated system and any person who will be affected may normally make representations to the FSA and the FSA will have regard to them in determining whether to revoke the designation order.

39 On making an order revoking a designation order, the FSA will give the designated system written notice and take steps to publish it as above. An order will state the date on which it takes effect. That date will not be earlier than three months after the day on which the revocation order is made.

# Schedule

Regulation 4(1)

## REQUIREMENTS FOR DESIGNATION OF SYSTEM

### Establishment, participation and governing law

- 1.- (1) The head office of at least one of the participants in the system must be in Great Britain and the law of England and Wales or Scotland must be the governing law of the system.
- (2) There must be not less than three institutions participating in the system, unless otherwise determined by the designating authority in any case where –
  - (a) there are two institutions participating in a system; and
  - (b) the designating authority considers that designation is required on the grounds of systemic risk.
- (3) The system must be a system through which transfer orders are effected.
- (4) Where orders relating to financial instruments other than securities are effected through the system –
  - (a) the system must primarily be a system through which securities transfer orders are effected; and
  - (b) the designating authority must consider that designation is required on grounds of systemic risk.

### Arrangements and resources

2. The system must have adequate arrangements and resources for the effective monitoring and enforcement of compliance with its rules or, as respects monitoring, arrangements providing for that function to be performed on its behalf (and without affecting its responsibility) by another body or person who is able and willing to perform it.

### Financial resources

3. The system must have financial resources sufficient for the proper performance of its functions as a system.

### **Co-operation with other authorities**

4. The system must be able and willing to co-operate, by the sharing of information and otherwise, with –
  - (a) the Financial Services Authority,
  - (b) the Bank of England,
  - (c) any relevant office-holder, and
  - (d) any authority, body or person having responsibility for any matter arising out of, or connected with, the default of a participant.

### **Specific provision in the rules**

- 5.- (1) The rules of the system must –
  - (a) specify the point at which a transfer order takes effect as having been entered into the system,
  - (b) specify the point after which a transfer order may not be revoked by a participant or any other party, and
  - (c) prohibit the revocation by a participant or any other party of a transfer order from the point specified in accordance with paragraph (b).
- (2) The rules of the system must require each institution which participates in the system to provide upon payment of a reasonable charge the information mentioned in sub-paragraph (3) to any person who requests it, save where the request is frivolous or vexatious. The rules must require the information to be provided within fourteen days of the request being made.
- (3) The information referred to in sub-paragraph (2) is as follows –
  - (a) details of the systems which are designated for the purposes of the Settlement Finality Directive in which the institution participates, and
  - (b) information about the main rules governing the functioning of those systems.
- (4) The rules of the system must require each participant upon –
  - (a) the passing of a creditors' voluntary winding-up resolution, or
  - (b) a trust deed granted by him becoming a protected trust deed,to notify forthwith both the system and the designating authority that such a resolution has been passed, or, as the case may be, that such a trust deed has become a protected trust deed.

### **Default arrangements**

6. The system must have default arrangements which are appropriate for that system in all the circumstances.