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Financial Services and Markets Bill
The Designated Activities Regime in the UK

The Financial Services and Markets Bill creates a Designated Activities Regime that will impact both authorised and unregulated firms. The Designated Activities Regime is intended to maintain the purview of the Financial Conduct Authority over certain activities, products and conduct that are currently regulated by retained EU law but that are not regulated activities under the existing Financial Services and Markets Act 2000 (FSMA). It forms part of the government's overall policy objective to establish a comprehensive FSMA model for financial services regulation. This briefing discusses that FSMA model, how the Designated Activities Regime will work, what it will be used for and what it could be used for, before signposting what firms should do now.

A comprehensive FSMA model

The Financial Services and Markets Bill (**FSM Bill**) implements the outcomes of the UK government's Future Regulatory Framework review (**FRF**). The FRF was established by the government to consider how the UK's financial services regulatory framework needs to adapt to the UK's new position outside the EU and ensure the regulatory framework is fit for the future.

The government's view throughout the FRF process has been that the existing Financial Services and Markets Act 2000 (**FSMA**) model, which delegates the setting of regulatory standards to the Prudential Regulation Authority (**PRA**) and the Financial Conduct Authority (**FCA**) in their capacity as expert, independent regulators, remains the most appropriate way to regulate financial services in the UK. The review concludes that the large number of detailed regulatory requirements which currently sit in retained EU law should, under a FSMA approach, generally be in the regulators' rules. The idea is that the regulators' rulebooks will (as far as possible) eventually become the single source of direct regulatory requirements for firms.

Many activities which are currently regulated directly in retained EU law are already regulated activities under the FSMA, and when retained EU law is revoked by the FSM Bill, these 'regulated activities' will continue to be regulated in line with the existing FSMA model. Under this model the PRA and FCA can make rules for 'authorised persons' and have powers to monitor and enforce compliance with those rules. Retained EU law also regulates a number of activities and market participants which do not fall within the regulatory perimeter of the FSMA. These include listing a company's shares on an exchange, entering into an OTC derivatives contract, and engaging in short selling. The government does not consider it appropriate to require all persons that are engaged on financial markets to become FSMA-authorised persons or to be supervised as if they are offering financial services directly themselves.

The FSM Bill therefore proposes to create the Designated Activities Regime to allow such activities that are 'related to financial markets' to be regulated within a framework that is separate to the FSMA's existing regime for authorised persons while still being compatible with a comprehensive FSMA model.

How does the Designated Activities Regime work?

The Designated Activities Regime will be established by a new Part 5A (*Designated Activities*) in the FSMA. This essentially creates a parallel licensing regime under the FSMA for designated activities.

New Section 71K provides a power for HM Treasury to make regulations providing for an activity to be a 'designated activity', but stipulates that such regulations may only designate activities as such if they relate to "financial markets or exchanges of the United Kingdom", or "financial instruments, financial products, or financial investments that are (or are proposed to be) issued or sold to, or by, persons in the United Kingdom".

New Section 71L sets the prohibition against carrying out 'designated' activities, or stipulates that they must take place in accordance with the relevant rules. New Section 71N provides a rule-making power for the FCA, which will enable it to make rules in relation to designated activities within the accountability and objectives framework for financial services regulators set by Parliament.

Notably, the FCA will only be able to make rules relating to specific designated activity; its remit will not extend to the wider unrelated activities of any person that carries out a designated activity, making this a narrower power than the FCA has over authorised firms. Persons carrying out designated activities will not therefore need to be FCA-authorised or meet any threshold conditions; they will only be required to follow the regulators' rules in relation to the specific designated activity itself.

The market will be keen to ensure a level playing field amongst FCA authorised, dual authorised and unregulated firms. Does new Section 71N mean that rule making in relation to designated activities will be the sole competency of the FCA? Currently the PRA and the Bank of England share regulatory responsibility with the FCA for a number of technical standards relating to the entering into of OTC derivatives, for instance. Additionally, if the requirements are set out in the FCA Handbook for authorised firms and in separate instruments for unauthorised firms, there may be a risk of divergence and inconsistency.

New Sections 71P and 71Q empower HM Treasury to provide for liability or compensation for breaches and to empower enforcement of the Designated Activities Regime. Any designated activity regulations made by the Treasury may make provision, *inter alia*, requiring the supply of information, about investigations, powers of entry, powers of inspection, search and seizure, powers of censure, and imposing monetary penalties.

What will the Designated Activities Regime be used for?

Schedule 6B of the FSM Bill sets out a non-exclusive list of proposed 'designated activities' which are drawn from various legacy EU regimes as follows:

– activities related to entering into derivatives contracts (UK EMIR) and holding positions in commodity derivatives (UK MiFIR);

- short selling (UK Short Selling Regulation);
- securitisation (UK Securitisation Regulation);
- offering securities to the public and admitting securities to trading on a securities market (UK Prospectus Regulation); and
- using and contributing to a benchmark (UK Benchmarks Regulation).

The intended purpose of the Designated Activities Regime therefore seems to be to enable the government to perpetuate the various retained EU law regimes. However, we have no detail on whether they will take effect on the same basis as today, or be subject to change, or indeed if any will be dropped.

What could the Designated Activities Regime be used for?

Schedule 6B is an indicative list only. While the Designated Activities Regime may at first be used to replace the retained EU law that is being revoked under the FSM Bill, there is no apparent limitation to the Treasury extending it in the future to new activities or activities which bring new risks.

The Designated Activities Regime is almost completely unconstrained in scope and effect – as such, it could potentially be used to ban all kinds of products and classes of provider, and/or to establish parallel licensing requirements for particular activities (both for authorised and unregulated firms). The explanatory notes to the Bill state "*Initially, the government expects most designated activities to be activities which are currently regulated through retained EU law*." – suggesting that new designated activities may be introduced.

It is not clear, in particular, what is intended by the term "financial investments", and why the Designated Activities Regime includes this at Section 71K alongside "financial instruments" and "financial products". Could this perhaps pave the way for cryptoassets and other novel investment products to be brought within the scope of UK regulation through secondary legislation?

This is particularly pertinent in light of the regulatory process within new Sections 71R and 71S; although extensions to the scope of primary legislation are subject to Parliamentary control under the latter, other modifications (even ones which criminalise breaches of an existing designated activity) are not. The regime could, arguably, be used to minimise Parliamentary oversight of changes to the regulatory perimeter.

What's next?

The next stage in the legislative process is for the FSM Bill to have its second reading in Parliament, which is due to take place on 7 September 2022, and the bill may be amended further as part of this process. It is not clear how long the bill will take to complete its passage through Parliament and the House of Lords, although it is likely the FSM Bill will receive Royal Asset by the end of this Parliamentary session in May 2023.

What should you be doing now?

1. Watch this space.

In-scope firms and (in particular) large unregulated corporates that carry out the types of activity listed at Schedule 6B of the FSM Bill will need to keep a watching brief on all relevant forthcoming regulatory consultations and proposed amendments to the legislation over the coming months. It remains to be seen how the Government will deal with policy changes arising from the migration from regulation under retained EU law to designation.

2. Prepare for the Designated Activities Regime.

Further down the line, changes to the wider supervision and enforcement landscape brought about by the Designated Activities Regime are likely to impact the relationship in-scope firms have with the FCA and firms' existing compliance programmes. This is likely to result in the need to amend internal and external policies and procedures as well as client-facing documentation. Firms should also consider how they propose to update their internal training programmes for employees to incorporate the Designated Activities Regime, as well as how they brief their clients on likely changes.

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