

# FINANCIAL SERVICES ACT 2012

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## EXPLANATORY NOTES

### COMMENTARY

#### Part 2 - Amendments of Financial Services and Markets Act 2000

##### Rules and guidance

##### *Section 24: Rules and guidance*

276. *Section 24* replaces Part 10 of FSMA with a *new Part 9A* which re-enacts Part 10 with amendments. *Chapter 1 of new Part 9A* sets out the general rule-making powers of the FCA and the PRA; *Chapter 2* deals with the modification, waiver and contravention of rules, and procedural provisions; *Chapter 3* makes provision for the FCA to issue guidance; *Chapter 4* makes provision for competition scrutiny; and *Chapter 5* makes provision for consequential amendments of references to rules and guidance in primary and secondary legislation.
277. *New section 137A* provides for the FCA to issue general rules applying to authorised persons. The rules may relate to the carrying on of regulated activities, and to the carrying on of activities which are not regulated; for example, rules may restrict authorised persons, or a particular description of authorised person (see *new section 137T*) from engaging in a particular activity. Any rules made by the FCA under this section must appear to the FCA to be necessary or expedient to advance one or more of its operational objectives. However, there need not be a direct relationship between the authorised persons to whom the rules apply and the persons whose interests are protected by the rules. Examples might be rules that address a firm's behaviour towards its competitors, potential clients or its beneficiaries.
278. *New section 137B* makes provision about general rules which relate to the handling of clients' money.
279. *New section 137C* provides that the FCA's power to make general rules includes a power to make rules in relation to the total cost or duration of credit agreements. The rules may prohibit authorised persons from entering into regulated credit agreements that provide for the payment by the borrower of charges of a specified description. "Charges" is defined in *subsection (2)* to mean all charges payable in connection with the provision of credit under the regulated agreement. It is immaterial whether the charge is imposed under the agreement itself or whether they are payable to a party to the agreement. The rules may also prohibit authorised persons from imposing charges of a specified description or which exceed a specified amount on a borrower under a regulated credit agreement or from entering into a regulated credit agreement that is (taken alone or with connected agreements) capable of remaining in force after the end of a specified period. The exercise of rights under a regulated credit agreement in such a way as to enable the agreement to remain in force beyond the period specified in the rules or to enable the imposition of excessive charges may also be prohibited.
280. *Subsection (4)* provides that the rules may provide that in relation to an agreement entered into, or obligation imposed, in contravention of the rules, that the agreement or

obligation is unenforceable; provide for the recovery of money or other property paid under the agreement; or provide for the payment of compensation. The application (or non-application) of this provision does not affect any other rights or remedies that the consumer may have under other legislation.

281. *Subsection (6)* defines “regulated credit agreement” as an agreement for the provision of credit (other than credit secured on land) where the entering into or administration of the agreement, or the exercise of rights of the lender under the agreement, is a regulated activity.
282. *New section 137D* provides that the FCA’s power to make general rules includes power to make rules that prohibit or restrict authorised persons from exposing consumers to an economic interest in specified products (“product intervention rules”). The power is limited to being exercised where the FCA considers that it is necessary or expedient to do so, for the purpose of securing an appropriate degree of protection for consumers or promoting effective competition or, if the Treasury so provides by way of order made under *subsection (1)(b)*, the integrity objective. The procedure for making such an order is set out in *new section 137E*. *New section 9P(2)(d)* of the Bank of England Act 1998 (inserted by *section 4*) provides that the FPC may give the Treasury recommendations about the exercise of this order making power. *Section 137D* does not limit the general rule making power in *section 137A* (see section 415A of FSMA).
283. *New section 137D(2)* lists the things that the FCA can specify as prohibited in its product intervention rules. These include: entering into specified agreements with any person or specified person; entering into specified agreements with any person or specified person unless requirements specified in the rules have been satisfied; doing anything else that might result in (a) the entering into of specified agreements by persons or specified persons or (b) the holding by them of a beneficial or other kind of economic interest in a specified agreement; or doing anything else unless certain requirements in the rules are met.
284. The power is intended to enable the FCA to impose restrictions in relation to specified products, or to ban them outright, where the FCA considers this is necessary or expedient to advance the consumer protection or the competition objective. The restrictions may include mandating the inclusion or exclusion of specific product features. They may also include specifying a class of consumer who may not be exposed to a particular product, or should only be exposed to it if certain conditions are met. When exercising this power the FCA must also have regard to the regulatory principles in *new section 3B*, including that the principle that a burden or restriction should be proportionate to the benefits which are expected to result from it. In accordance with these principles, the FCA would, for example, consider whether it is more appropriate to place restrictions on products than to ban them outright.
285. *Subsection (7)* provides that the FCA may attach specific provisions to such rules as to the effect of contravention of such rules including that agreements entered into in breach of rules made under this provision are rendered unenforceable against a consumer. These provisions would only apply to contracts entered into after the product intervention rules had come into force; they would not apply to contracts entered into before that date.
286. Consumers who have entered into agreements concerning “products” that are later “banned” or “restricted” would not be able to rely on new rules (that postdate their contracts) in order for their contracts to be rendered unenforceable against them and to establish their automatic entitlement to a refund or compensation. However, such consumers may seek redress from existing provisions of FSMA or rules made under the powers in FSMA. For example the FSA Handbook would apply to agreements entered into prior to product intervention rules coming into force.
287. *Section 137F* provides that the power of the FCA to make general rules includes power to make rules requiring authorised persons to take specified steps in connection with

the setting by a specified person of a specified benchmark, for example rules requiring participation in the setting of a benchmark specified in the rules. The rules may in particular make ambulatory references to any code or other document published by the person responsible for the setting of the benchmark (that is, rules that refer to the code or document as it may be amended from time to time). The FCA may provide that specified requirements are to be met in relation to the code or document (for example, that amendments to it must be the subject of prior consultation with the FCA).

288. The PRA may make general rules under *new section 137G*. The PRA's general rules may only apply to PRA-authorized persons, but may relate to the carrying on of both regulated activities and activities which are not regulated. Any rules made by the PRA under this section must appear to the PRA to be necessary or expedient to advance any of its objectives. However, there need not be a direct relationship between the authorized persons to whom the rules apply and the persons who are protected by the rules.
289. General rules made by either regulator can impose restrictions on the remuneration of staff and others (*new section 137H*), and may provide (i) that provisions in an agreement which breach the restrictions are void and (ii) for the recovery of payments made or property transferred under a void provision.
290. General rules may also require authorized persons to have and comply with a remuneration policy (*new section 137I*). If rules contain a requirement for such a policy the Treasury may direct the regulator to review the compliance by a specified authorized person, or description of authorized persons, with the rules on remuneration policies. If there is non-compliance, the regulator must take such steps as it considers appropriate to deal with the non-compliance, for example requiring the authorized person to review its remuneration policy.
291. Part 1 of the Banking Act 2009 establishes a special resolution regime (SRR), providing statutory tools to deal with banks and building societies that get into financial difficulties. General rules made by either regulator under FSMA may require those in respect of whom the SRR may be exercised (such as banks and building societies) to prepare recovery plans. Recovery plans are plans setting out action to be taken to secure the carrying on of the business, or information to facilitate the carrying on of the business. Action described in the plan may include the restructuring, scaling back or sale of certain business lines or assets of the authorized person in question. The purpose of a recovery plan is not to help an authorized person to avoid getting into difficult circumstances, but to plan what they can do to enable them to recover should they encounter such circumstances.
292. *New section 137J* provides that, before they prepare rules about recovery plans, the regulators must consult the Treasury and the Bank, both of whom have roles under Part 1 of the Banking Act 2009.
293. Similarly, *new section 137K* provides that the PRA must consult the Treasury and the Bank before making general rules requiring the preparation of resolution plans. A resolution plan is a plan setting out (i) steps to be taken in the event of it becoming likely that the business will fail or in the event of it failing, and/or (ii) information to facilitate anything that falls to be done in consequence of the failure of the business. Resolution plans might include provisions to ensure that a "data room" can be set up quickly and effectively, or contain information about the simplification of legal structures ahead of a resolution being triggered. *Subsection (6)* confirms that information that would facilitate planning by the Treasury and the Bank for the exercise of their powers under the Banking Act 2009 is eligible for inclusion in a resolution plan. Where the PRA has made rules requiring the preparation of resolution plans, *new section 137M* requires it to consult the Treasury and the Bank about the adequacy of the plans prepared.
294. *New section 137N* makes further provision in respect of recovery plans and resolution plans. To prepare a recovery or resolution plan, an authorized person or a skilled person appointed under section 166A is likely to need to obtain information from

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various other persons. *Subsection (1)* facilitates the flow of information to the authorised person, or the skilled person, for the purposes of preparing a recovery or resolution plan, for example other companies in the group, or persons such as service providers, without there being a breach of any duty or obligation of confidence. *Subsection (2)* provides that an authorised person that has received confidential information under subsection (1) may, for example, include such information in its recovery or resolution plan and submit it to the relevant regulator without having to seek the consent of a third party.

295. *New section 137O* enables each regulator to make rules (to be known as “threshold condition codes”) which supplement the threshold conditions which are set out in Schedule 6 and expressed to be relevant to the discharge of that regulator’s functions. Under *new section 55B*, references to the “threshold conditions” means the conditions set out Schedule 6 as read with any threshold condition code made by the regulators in relation to those conditions. *Subsection (3)* provides that a threshold condition code may in particular specify requirements a person must satisfy to be regarded as satisfying a particular condition and specify matters which are, or are not, relevant in determining whether a particular condition is satisfied. *Subsection (5)* provides that a threshold condition code cannot be enforced otherwise than by reference to the threshold conditions. For example a financial penalty could not be imposed on an authorised person by reference to a contravention of threshold condition code.
296. *New section 137P* provides that the regulators may make rules about the disclosure and use of information held by an authorised person. These rules are commonly known as “Chinese walls” rules. Chinese walls are barriers in the form of procedures, systems, management and physical separation which firms may employ in order to ensure that information obtained by one part of a firm is not communicated in inappropriate circumstances to another part of the firm (for example, where it would advantage one client at the expense of another). Under *subsection (2)(a) and (c)*, rules may require that information be withheld or not used for a customer’s benefit where it would otherwise have to be disclosed or used, while *subsection (2)(b) and (d)* provide that rules may specify circumstances in which an authorised person may withhold or not use information which would otherwise have to be disclosed or used. This means that, if an authorised person maintains Chinese walls in accordance with rules made under the section, then the authorised person will not be subject to obligations as to the disclosure and use of information that would otherwise apply.
297. *New section 137Q* confers a power on the FCA to make rules specifying when and how authorised persons may take steps to stabilise the price of investments, and are to be treated as acting in accordance with price stabilising rules.
298. Section 21 of FSMA prohibits financial promotion (the communication, in the course of business, of an invitation or inducement to engage in investment activity) other than by or with the approval of an authorised person. *New section 137R* confers a power on the FCA to make rules applying to authorised persons in relation to the regulation of financial promotion. *Subsection (7)* enables the Treasury to restrict this rule-making power.
299. *New section 137S* enables the FCA to direct a firm to withdraw a financial promotion that the FCA considers has breached or is likely to breach its rules concerning financial promotions, and to disclose the fact that it has done so. This provision is intended to enable the FCA to take swift action to minimise consumer detriment. It includes power to take action in relation to a financial promotion, if it was made or approved by an authorised person. The FCA can direct the firm to refrain from making a promotion, to withdraw a promotion, to publish details of it, or to do anything else the FCA directs it to do in relation to the promotion. It is envisaged this might include, for example, contacting consumers who have acted upon the promotion. *Subsection (3)* is intended to prevent firms from making promotions that are materially the same as the promotion in relation to which a direction already exists.

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300. The FCA must give the person to whom written notice of a direction under *subsection (5)* is addressed an opportunity to make representations, during which time the fact of the notice cannot be published by the FCA. After this period, the FCA will amend (*subsection (7)*), revoke (*subsection (10)*) or confirm (*subsection (8)*) its original direction. At this stage, the FCA may publish such details of the action it has taken as it considers appropriate. There is nothing to prevent a firm from publishing details about the matter from the moment the FCA makes the direction. A firm must publish any details about the promotion that the FCA requires it to under *subsection (2)(c)*.
301. *New section 137T* makes supplementary provision in relation to the rule-making powers of the FCA and the PRA, including provision permitting rules of one regulator to cross-refer to rules of the other regulator.
302. *New sections 138A and 138B* provide for the regulators to give directions waiving or modifying rules applicable to an authorised person, at the request of an authorised person or with their consent; but threshold condition code, trust scheme rules and scheme particular rules may not be waived or modified. *Subsection (4) of new section 138A* sets out the conditions which must apply for each regulator to give a direction. Waivers or modifications of rules can have indefinite effect, or can be revoked or varied. *New section 138B* provides that the regulator should publish the direction unless it is inappropriate or unnecessary: *subsection (3)* sets out the factors the regulator must consider in determining whether publication of the direction is inappropriate or unnecessary. Those factors include consideration of whether a breach of the rule in question would give rise to a right of action by a person under *new section 138D*: persons affected by the modification or waiver will include clients of the authorised person, and other authorised persons who might wish to benefit from similar arrangements.
303. *New section 138C* enables the regulators to disapply in relation to specific rules the normal consequences of contravention, such as the disciplinary provisions in Part 14 of FSMA. For example, a PRA rule on capital requirements could provide that contravention of the rule does not lead to the disciplinary consequences that would normally attach to breach of that rule, provided that contravention may be relied on as tending to establish contravention of another specified PRA rule. The regulators may not, however, disapply the normal consequences of a breach of threshold condition code or rules made under *new section 192J* (provision of information by parent undertakings).
304. *New section 138D* sets out the circumstances in which persons who suffer loss as a result of the breach of a rule by an authorised person have a right of action for damages for resulting losses. It does not remove any common law cause of action which a person might otherwise have. Breach of an FCA rule (unless the rule provides otherwise) will give private persons who suffer loss as a result of the breach a right of action for damages: they will need only show that there has been a breach of a rule as a result of which they have suffered loss rather than having to rely on that breach as evidence of negligence. PRA rules may provide for the same effect. There is a presumption that persons other than private persons do not have a right of action for damages, although the Treasury may by regulations specify that breaches of certain rules are actionable by non-private persons. "Private persons" will be defined by the Treasury by regulations. The section does not apply to listing rules, threshold condition code, short selling rules, rules made under *new section 192J* (provision of information by parent undertakings) or capital adequacy rules.
305. *New section 138E* provides that a breach of rules is not an offence, and that it does not make a transaction unenforceable or void. This provision does not apply to rules made by the FCA under section 137C (rules on the cost or duration of credit agreements) or section 137D (product intervention rules).
306. If either regulator makes, amends or revokes any rules, it must immediately notify the Treasury and the Bank in writing (*new section 138F*).

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307. *New section 138G* provides that rules must be made in writing and specify the provision under which they are made. Each regulator must publish its rules; if a person can show that a rule had not been made available at the time they are alleged to have contravened it, *subsection (6)* provides that the person is not to be taken as having contravened the rule.
308. *New section 138I* provides that, before the FCA makes any rules, it must consult the PRA and then publish a draft of the rules accompanied by various materials, including a cost benefit analysis, an explanation of the rules and an explanation of how making the rules is compatible with its objectives and with the regulatory principles set out in *new section 3B*. It must invite representations on the draft rules. A “cost benefit analysis” is an analysis of the costs and of the benefits that will result from the rule being made and the analysis should include an estimate of the costs and of the benefits where possible. If the FCA is of the opinion that it is not possible to produce an estimate of the costs and benefits, it must publish a statement with an explanation of that opinion. The FCA must have regard to any representations it receives on the draft rules, and publish an account of those representations and its response to them. If the issued rules differ from the draft rules, the FCA must publish details of the differences and a further cost benefit analysis.
309. *New section 138J* makes corresponding provision for rules made by the PRA.
310. *New section 138K* provides that, where a rule proposed by the FCA or PRA is to apply both to mutual societies (as defined in *subsection (5)*) and other authorised persons, the regulator must publish with the draft rule a statement of its opinion as to whether the rule will affect mutual societies significantly differently from other authorised persons and, if so, how. It must also publish a statement when the rule is made if the rule differs from the draft rule. In this case the statement must explain the effect of the difference on mutual societies, and on mutual societies as compared with other authorised persons.
311. Where delay would prejudice the interests of consumers, *new section 138L* provides that the FCA does not need to observe certain procedural requirements (though it must always consult the PRA); and where there would be no or minimal increase in costs, the FCA does not need to publish a cost benefit analysis. Similarly, where delay would prejudice the safety and soundness of PRA authorised persons or, where *new section 2C* (the insurance objective) applies, the appropriate degree of protection for policyholders, the PRA does not need to observe certain procedural requirements. Again, the PRA must in all cases consult the FCA.
312. *New sections 138M to 138O* specify the circumstances in which an exemption can be made from the obligation to consult and prepare a cost-benefit analysis on proposed rules where the FCA proposes to make product intervention rules under *new section 137D*. This provision enables the FCA to intervene more quickly in relation to a product where it considers it necessary or expedient not to do so for the purposes of advancing its consumer protection or competition objective (or its integrity objective, if the Treasury so provides by order). Any rules made pursuant to these provisions are temporary and must cease to have effect within 12 months of the day on which they come into force. It is open to the FCA to revoke any such rules before the 12 month period expires. But the FCA may not within the following year make further temporary product intervention rules which are substantially the same as temporary rules which have lapsed.
313. *New section 138O* requires the FCA to issue a statement of policy with respect to the making of temporary product intervention rules. This will describe, amongst other things, the circumstances in which the FCA might make temporary product intervention rules and the factors that it will generally consider before doing so. Under *new section 138O* the FCA must consult on any such statement before it issues it (and it follows logically that, unless there are exceptional circumstances, it should do so before it may make temporary product intervention rules). The FCA is expected only to make temporary product intervention rules that fall within the limits set out in a statement issued under *new section 138O*.

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314. The FCA may give guidance under *new section 139A* about the operation of FSMA or specified parts of it, and of any rules the FCA has made. The FCA may also give guidance in relation to the FCA's functions (which *new section 1A(6)* of FSMA, inserted by section 6 of the Act, defines as including functions under the Act, the Insolvency Act 1986, the Banking Act 2009 and provisions of EU law specified by order by the Treasury for this purpose) or any other matter the FCA considers relevant. The guidance need not be published, though the FCA may do so; and if the FCA gives guidance in response to a request, it may make a reasonable charge for that guidance (*subsection (6)*).
315. If the FCA intends to give guidance on its rules to FCA-regulated persons generally or to a class of FCA-regulated persons ("general guidance"), it must consult the PRA and then publish a draft of the guidance, inviting representations on it. The FCA must have regard to any representations received and publish an account of those representations and its response to them (*subsections (3) and (4)*). As with the making of rules, the FCA does not need to observe these procedural requirements if doing so would prejudice the interests of consumers. *New section 139B* requires the FCA to notify the Treasury if it issues, amends or revokes its general guidance.
316. *New sections 140A to 140H* relate to the scrutiny of the regulators' regulating provisions and practices by the competition authorities (the Office of Fair Trading ("OFT") and the Competition Commission).
317. Under *new section 140B and 140G*, where the OFT gives advice to the PRA or FCA under section 7 of the Enterprise Act 2002, being advice stating that the OFT considers that the regulating provisions or practices of either regulator (or a combination of both) may cause or contribute to the prevention, restriction or distortion of competition in the supply or acquisition of goods and services in the United Kingdom or that a feature of the market that could be dealt with by regulating provisions or practices of either regulator (or both) has that effect, the regulator is required to respond to the advice within 90 days. Similar provision applies where the Competition Commission makes a recommendation to the regulator in a report under section 136 of the Enterprise Act 2002 (reports on market investigation references). The regulator is not required to accept and act on the advice but must have regard to the advice and state, with its reasons, how it proposes to deal with the advice. Any response from the regulator must be published.
318. Under *new section 140H* if, having considered the response of the regulator, the OFT or Competition Commission continues to consider that the regulating provisions or practices of either regulator (or a combination of both) may cause or contribute to the prevention, restriction or distortion of competition in the supply or acquisition of goods and services in the United Kingdom, the OFT or Competition Commission may refer the matter to the Treasury. The Treasury may, having considered the advice given by the competition authority and the regulator's response and having consulted the regulator, give a direction to the regulator requiring the regulator to take specified action.
319. *New section 141A* confers on the Treasury and the Secretary of State an order-making power to amend legislation which makes reference to rules of either regulator or to guidance issued by the FCA. This power only allows the Treasury or the Secretary of State to amend such references where the regulator has altered or revoked its rules or guidance. Under section 429 of FSMA, such orders will be subject to the negative procedure.