



HM TREASURY

Regulating certain bidders in auctions of EU emissions allowances

February 2012



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1

Introduction

1.1 The changes proposed in this consultation document are intended to implement elements of the EU regulatory framework applicable to certain bidders in Government auctions of aviation and phase III EU emissions allowances under the EU Emissions Trading System (EU ETS).

1.2 EU regulation requires certain persons that wish to bid in EU ETS auctions of aviation and phase III emissions allowances across Europe, to be regulated by the competent national authority (in the UK this is the Financial Services Authority (FSA)).

1.3 This document sets out the rationale for the proposed amendments to existing legislation on financial services and includes the draft implementing Orders.

The EU Emissions Trading System

1.4 The EU ETS is at the heart of UK Government policy to tackle climate change. The system covers sectors responsible for around half of the UK's carbon dioxide emissions. The EU ETS is expected to deliver annual carbon savings of 51 mega tonnes of carbon dioxide in 2020 – a reduction in the emissions of the power sector and heavy industry of 22 per cent based on 2008 levels.

1.5 The EU ETS works on a 'cap and trade' basis. A cap is set on EU Member States' emissions, which declines over time. EU emissions allowances equal to each year's cap are then issued and allocated to sectors covered by the system. Allowances can be allocated for free or auctioned by national governments.

Phase III of the EU Emissions Trading System

1.6 The regulatory framework for auctioning aviation and phase III emissions allowances is contained in the Commission Regulation (EU) No 1031/2010, as amended by Commission Regulation (EU) No 1210/2011. Specific elements of the 'Auctioning Regulation' (AR) require implementation by EU Member States to allow certain persons to participate in the auctions.

1.7 Implementing these elements of the AR will result in the creation of a new regulated activity under the Financial Services and Markets Act (2000) (FSMA). In most cases this will lead to the FSA having to authorise relevant persons who wish to bid in auctions of emissions allowances; irrespective of extant permissions or exemptions that they may currently hold or rely on. This involves amending secondary legislation made under FSMA and some minor additions to the Act itself.

The Financial Services Authority

1.8 In the UK the FSA will authorise and regulate the relevant persons wishing to bid in auctions of emissions allowances. The FSA will be consulting on the consequential changes required to their Rulebook.

Who should read this

1.9 These changes will directly affect:

- investment firms and credit institutions authorised under the Markets in Financial Instruments Directive (2004/39/EC) or the Capital Requirements Directive (2006/48/EC) that wish to bid in auctions on behalf of others; and
- persons covered by the exemption in Article 2(1)(i) of the Markets in Financial Instruments Directive (2004/39/EC) that wish to bid in auctions on their own account or on behalf of others.

How to respond

1.10 HM Treasury invites comments on the proposals and the specific questions contained in this document. The questions are summarised in Annex D.

1.11 The consultation period will end on 10th April 2012.

1.12 Please send responses to:

euetsconsultation@hmtreasury.gsi.gov.uk, or

EU ETS Consultation
Environment and Transport Tax Team
3rd Floor
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

1.13 HM Treasury would be happy to meet to discuss your thoughts on these proposals. Please email the address above if you would like to do this.

Confidentiality

1.14 When responding please state whether you are responding as an individual or representing the views of an organisation. Written responses may be published on HM Treasury's website unless the author requests otherwise. In the case of electronic responses, general confidentiality disclaimers that often appear at the bottom of e-mails will be disregarded for the purpose of publishing responses, unless an explicit request for confidentiality is made in the body of the response. If you wish part, but not all, of your response to remain confidential please supply two responses – one for potential publication, with the confidential information deleted, and one confidential version.

2

Amendments in relation to the Financial Services and Markets Act 2000

2.1 The recitals to the EU Auctioning Regulation (AR) explain that confidence in the integrity of the EU Emissions Trading System (EU ETS) auction processes is a prerequisite for ensuring auction participation and a competitive auction outcome. Bidders in the auctions should therefore be subject to minimum requirements for adequate customer due diligence checks.

2.2 To achieve this in a cost effective way, eligibility to apply for admission to bid in auctions of emissions allowances is restricted to certain defined groups of participants. These include operators of installations and aircraft operators covered by the EU ETS and regulated financial entities such as investment firms and credit institutions.

2.3 As well as direct participation, the AR also provides for participants to be able to access auctions through intermediaries. These may be financial intermediaries or other persons authorised to bid on their own account or on behalf of clients of their main business.

Relevant provisions of the Auctioning Regulation

2.4 Article 18 of the AR sets out the persons eligible to apply for admission to bid in the auctions. In summary, these are:

- (i) Operators of installations or aircraft operators covered by the emissions trading scheme (essentially users of emissions allowances who need to buy allowances for compliance purposes) or groups of such operators or public bodies that control them.
- (ii) Investment firms or credit institutions authorised under the Markets in Financial Instruments Directive (2004/39/EC) or the Capital Requirements Directive (2006/48/EC).
- (iii) Persons who are covered by the exemption in Article 2(1)(i) of the Markets in Financial Instruments Directive (MiFID) for dealing on own account in financial instruments where this is ancillary to their main business.

2.5 Eligibility for persons in (iii) above is dependent on the Member State in which the person is established having enacted legislation enabling the relevant competent authority (the Financial Services Authority (FSA) for persons in the UK) to authorise them to bid. Where investment firms or credit institutions under (ii) above are bidding, on behalf of others, for auctioned products that are not financial instruments¹, eligibility is similarly dependent on legislation to enable the competent authority to grant authorisation.

2.6 Article 6(5) of the AR deems the reception, transmission, and submission of a bid by an investment firm or credit institution on any auction platform to be an investment service within the meaning of MiFID where the auctioned product is a financial instrument.

2.7 Article 59 of the AR sets out conduct rules for persons authorised to bid on behalf of others.

¹ The AR provides for auction allowances in the form of five-day futures or two-day spots – the latter are not financial instruments under MiFID

Changes to Financial Services and Markets Act 2000 and related legislation

2.8 To ensure that all persons in the eligible groups are able to take part in auctions in the UK – thereby giving effect to the requirements of the AR and promoting full participation in auctions – some changes are necessary to secondary legislation made under the Financial Services and Markets Act 2000 (FSMA) and minor amendments will be required to the Act itself.

2.9 The proposed approach makes bidding in auctions of emissions allowances, whether auctioned in the form of two-day spots or five day futures, a new regulated activity for all participants, subject to certain exclusions (article 2 of the draft Order at Annex A). Exclusions from the new regulated activity are made for certain groups where authorisation is not required: operators or aircraft operators, business groupings of such persons, or public bodies that control such persons.

2.10 A further exclusion is made for bidding by investment firms and credit institutions bidding on their own account. For bidders who are based in the UK and not subject to an exception, the fact that bidding is a specified activity triggers the provisions of FSMA which require those wishing to bid to apply to the FSA for permission to carry on the new regulated activity, irrespective of currently held permissions.

2.11 We also amend FSMA. For bidders who are based outside the UK but elsewhere in the EEA, amendments to Schedule 3 of FSMA extend the existing passporting arrangements for European investment firms and credit institutions so that such firms can bid in emissions auctions where they are authorised to do so in their home state. Passporting arrangements are also extended so that European MiFID-exempt firms who have received authorisation in their home state can bid in UK auctions.

2.12 Where a firm based elsewhere in the EEA wishes to bid in UK emissions auctions, but not to carry on any other regulated activity in the UK, these passporting arrangements are light-touch. The only precondition is that the firm is authorised to bid in its home state under the AR. However, providing that such firms are within the scope of FSMA means that the FSA will have supervisory powers over them.

2.13 The draft Order also disapplies preconditions for UK firms who are authorised to bid under the AR and wish to passport into other EEA states in order to bid in emissions auctions, providing a similarly light-touch regime for UK firms wishing to bid overseas.

2.14 Consistent with an approach which aims to keep changes to the minimum required by the AR, a specific new regime for incoming MiFID-exempt firms is not proposed. All persons bidding on a regulated auction platform will be subject to the rules of that platform.

Box 2.A: Questions on the amendments in relation to the Financial Services and Markets Act 2010

- 1 Do you agree that the approach proposed gives effect to the AR in an effective and proportionate manner?
- 2 Do you agree there should be a new regulated activity for all categories of bidders, including credit institutions and investment firms, which covers the reception, transmission or submission of a bid for all auctioned products, including auctioned products which are financial products within the meaning of MiFID?
- 3 Do you agree that the approach for MiFID-exempt firms is the right one?
- 4 Have you any other comments about the changes to FSMA and related legislation?
- 5 Do you agree with the assessment of the impacts of these proposals (found in Annex C)?

Amendment to the Recognised Auction Platform Regulations 2011

2.15 In article 7 of the draft instrument at Annex A, new provisions are added to the Recognised Auction Platform Regulations 2011. These give effect to requirements in the AR for the competent authority to have the power (and the procedure to be applied when exercising the power) to impose civil penalties for contraventions of the Regulations by auction platforms in certain circumstances relating to grounds for refusal or suspension of admission to bid, and monitoring the relationship with bidders.

Box 2.B: Question on the amendment to the Recognised Auction Platform Regulations 2011

- 6 Do you have any comments on the proposed amendments to the Recognised Auction Platform Regulations 2011?

3

Amendments in relation to the Money Laundering Regulations

- 3.1** Article 59 of the EU Auctioning Regulation (AR) sets out conduct rules for persons authorised to bid on behalf of others under Article 18(2) and (3).
- 3.2** Article 59(4) provides that competent national authorities are responsible for authorising such persons to bid, and for monitoring their compliance with the rules.
- 3.3** Article 59(5)(c) provides that the authorities shall only authorise such persons where they comply with the requirements of national legislation transposing Directive 2005/60/EC (the Third Money Laundering Directive or 3MLD). In the UK the relevant national legislation is the Money Laundering Regulations 2007 (MLRs), Schedule 3A to the Terrorism Act 2000 and Schedule 9 to the Proceeds of Crime Act 2002.
- 3.4** Article 18 sets out the persons eligible to apply to bid on behalf of others in auctions of emissions allowances.
- 3.5** The persons covered by Article 18(3) of the AR - investment firms and credit institutions – are already subject to the MLRs, and no regulatory change is required in respect of them.
- 3.6** Article 18(2) refers to people who are covered by the exemption at Article 2(1)(i) of Directive 2004/39/EC (the Markets in Financial Instruments Directive or MiFID). The exemption currently covers firms for whom the provision of commodity derivatives services, while connected to their core business, is not their core business.
- 3.7** Without prejudice to that exemption, these firms are eligible to apply to bid on behalf of others provided the Member State has enacted legislation enabling them to do so, including subjecting them to the relevant national anti-money laundering legislation. Businesses falling within the MiFID exemption are not currently subject to the MLRs and as such would not meet the requirements set out in the AR should they wish to bid on behalf of others in auctions of emissions allowances.
- 3.8** In order for these firms to meet the anti-money laundering requirements, the Government is considering legislating so that MiFID-exempt firms who want to apply to bid on behalf of others have to comply with the requirements of the MLRs when carrying out that activity.
- 3.9** This would make MiFID-exempt firms subject to the requirements of the MLRs to the extent that they bid on behalf of others for the purposes of the AR. It would also mean that they comply with the requirements set out in Article 59(5)(c) of that Regulation and can accordingly be authorised to bid on behalf of others and to tap into the auctioning market.
- 3.10** Legislating will provide legal certainty with regard to the extent and nature of the bidder's anti-money laundering obligations. Under this option all firms falling under Article 2(1)(i) of MiFID which engage in bidding for emission auctions would need to comply with all the requirements set out in the MLRs including on customer due diligence, record keeping and monitoring of transactions. They would be subject to anti-money laundering supervision and to the range of regulatory and criminal sanctions related to the MLRs. Under this arrangement, the FSA will have statutory powers and the mandate to supervise and sanction accordingly in line

with the current arrangement under the MLRs.

3.11 This option creates a level-playing field in that MiFID-exempt bidders failing to comply with the MLRs will be subject to similar supervision arrangements and sanctions as other non-MiFID exempt bidders.

3.12 As an alternative, the Government explored whether it would be possible to satisfy the requirements under Article 59(5)(c) of the AR; circumventing the extension of the MLRs to MiFID exempt firms by relying on the direct effect of the AR. Under this approach the competent authority, the FSA, would require such firms to demonstrate that they carry out anti-money laundering procedures of the same standards as the requirements set out in the MLRs before they could be authorised to bid on behalf of others.

3.13 However this arrangement would go against the intention behind Article 59(5) of the AR which aims to extend the applicability of the 3MLD rules to Article 18(2) entities. As such, it would not be appropriate or sufficient for the competent authority to merely satisfy itself that a prospective candidate currently under the MiFID exemption, is not currently bound by the national legislation transposing the AML Directive. Such interpretation is not consistent with the purpose of this condition or the authority's supervisory duties set out in paragraph 6 of Article 59 of the AR.

Box 3.A: Questions on Anti-Money Laundering compliance

- 7 Do you agree that the Government's approach is a fair and transparent solution to ensure MLR compliance by MiFID-exempt firms under article 2(1)(i)?
- 8 Do you have any comments on the proposed amendments to the anti-money laundering legislation?
- 9 Do you agree with the assessment of the impacts of these proposals (found in Annex C)?



Draft Order in relation to the Financial Services and Markets Act 2000

A.1 The following pages contain the draft statutory instruments for the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2012.

DRAFT STATUTORY INSTRUMENTS

2012 No.

FINANCIAL SERVICES

The Financial Services and Markets Act 2000 (Regulated Activities)(Amendment) Order 2012

Made - - - - - ***

Coming into force - - - - - ***

In the opinion of the Treasury, one of the effects of the following order is that an activity which is not a regulated activity (within the meaning of the Financial Services and Markets Act 2000(a)) will become a regulated activity.

The Treasury are a government department designated(b) for the purposes of section 2(2) of the European Communities Act 1972(c) in relation to measures relating to the operation of regulated markets and clearing or settlement systems and in relation to insider dealing and market manipulation.

The Treasury, in exercise of the powers conferred upon them by sections 2(2) of the European Communities Act 1972, and sections 22(1) and (5), 426 and 428(3) of, and paragraph 25 of Schedule 2 to, the Financial Services and Markets Act 2000, hereby make the following Order.

PART 1

GENERAL

Citation, commencement and interpretation

1.—(1) This Order may be cited as the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2012, and comes into force on [].

(2) In this Order, “emission allowance auctioning regulation” means Commission Regulation (EU) No 1031/2010 of 12 November 2010(d) on the timing, administration and other aspects of auctioning of greenhouse gas emission allowances pursuant to the emission allowance trading directive.

(a) 2000 c.8.

(b) S.I. 1993/2661; S.I. 2004/2642.

(c) 1972 c. 68. Section 2(2), and Schedule 2 to the 1972 Act were amended by section 27 of the Legislative and Regulatory Reform Act 2006 (c.51); and by section 3 of, and the Schedule to, the European Union (Amendment) Act 2008 (c. 7).

(d) OJ L 302, p 1, 18.11.2010.

PART 2
AMENDMENT OF THE REGULATED ACTIVITIES ORDER

Amendment of the Regulated Activities Order

2.—(1) The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001(**a**) is amended as follows.

(2) In article 3(1) (interpretation)—

(a) for the definition of “investment services and activities”(**b**), substitute—

““investment services and activities” means—

(a) any service provided to third parties listed in Section A of Annex 1 to the markets in financial instruments directive (the text of which is set out in Part 3 of Schedule 2) read with Article 52 of Commission Directive 2006/73/EC of 10 August 2006(**c**) (the text of which is set out in Part 4 of Schedule 2), including the reception, transmission or submission of a bid (as defined in Article 3.5 of the emission allowance auctioning regulation) by an investment firm or credit institution on any auction platform; or

(b) any activity listed in Section A of Annex 1 to that directive, relating to any financial instrument;”;

(b) insert the following definitions in the appropriate place—

““auction platform” means a platform on which auctions of greenhouse gas emissions allowances are held in accordance with the emission allowance auctioning regulation;”;

““emission allowance trading directive” means Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowances trading with the Community(**d**);

“greenhouse gas emissions allowances” mean “allowances” as defined in Article 3(a) of the emission allowance trading directive;”;

(3) Insert after article 24 (other exclusions)—

“CHAPTER 5A

BIDDING IN EMISSIONS AUCTIONS

The activity

Bidding in Emissions Auctions

24A.—(1) The reception, transmission or submission of a bid at an auction of an investment of the kind specified by article 82A conducted—

(a) on a recognised auction platform, or

(b) on any other auction platform which has been appointed under the emission allowance auctioning regulation,

is a specified kind of activity.

(2) An activity which falls within paragraph (1) (or would do so but for the exclusions in article 24B) does not form part of any other activity specified under any other article of this Order.

(3) In this article—

(a) S.I. 2001/544.

(b) The definition of “investment services and activities” was inserted by S.I. 2007/126.

(c) OJ L 241, p 26, 2.9.2006.

(d) OJ L 275, p 32, 25.10.2003.

- (a) “recognised auction platform” has the meaning given in regulation 1(3) of the Recognised Auction Platform Regulations 2011;
- (b) “reception”, “transmission” and “submission” have the same meaning as in the emission allowance auctioning regulation.

Exclusions

Miscellaneous exclusions

24B.—(1) There is excluded from article 24A any activity carried on by—

- (a) an operator or an aircraft operator having an operator holding account, bidding on its own account, including any parent undertaking, subsidiary undertaking or affiliate undertaking forming part of the same group of undertakings as the operator or the aircraft operator;
- (b) business groupings of persons listed in sub-paragraph (a) bidding on their own account or acting as an agent on behalf of their members; or
- (c) public bodies or state-owned entities of the Member States that control any of the persons listed in sub-paragraph (a).

(2) There is excluded from article 24A the reception, transmission or submission of a bid by an investment firm or a credit institution on any auction platform on their own account for investments of the kind specified by article 82A.

(3) There is excluded from article 24A the reception, transmission or submission of a bid by any person to whom paragraph (i) of Article 2.1 of the markets in financial instruments directive (the text of which is set out in Schedule 3) applies, on their own account or on behalf of clients of their main business, where that person has received authorisation under Article 59 of the emission allowance auctioning regulation from a competent authority in an EEA State other than the United Kingdom.

(3) In this article, “operator” has the same meaning as in the emission allowance trading directive.”.

(4) Insert after article 82 (rights under a pension scheme)—

“Greenhouse gas emissions allowances

82A. Greenhouse gas emissions allowances which are auctioned as financial instruments or as two-day spots within the meaning of Article 3.3 of the emission allowance auctioning regulation.”.

PART 3

CONSEQUENTIAL AND MISCELLANEOUS AMENDMENTS

Amendment of the Financial Services and Markets Act 2000

3.—(1) The Financial Services and Markets Act 2000 is amended as follows.

(2) In section 39(4)(a) (exemption of appointed representatives), after “markets in financial instruments directive” insert “or in the emission allowance auctioning regulation”.

(3) In section 45 (variation on the Authority’s own initiative), after subsection (2B)(b), insert—

(a) Section 39(4) was amended by S.I. 2007/126, Schedule 5, paragraphs 1 and 2(b).
 (b) Sub-section (2B) was inserted by S.I. 2007/126.

“(2C) Without prejudice to the generality of subsections (1) and (2), the Authority may, in relation to an authorised person who has permission to carry on the regulated activity specified in article 24A of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, exercise its powers under this section to vary the Part IV permission of the person concerned to remove that activity from those to which the permission applies if it appears to the Authority that that person has seriously and systematically infringed the provisions of paragraph 2 or 3 of Article 59 of the emission allowance auctioning regulation.”.

(4) In section 59(8) (approval for particular arrangements), after “the single market directives” insert “or the emission allowance auctioning regulation”.

(5) In section 66(2)(a) (disciplinary powers), after “the markets in financial instruments directive or the UCITS directive” insert “or by the emission allowance auctioning regulation”.

(6) In section 138(6) (general rule-making power), after “the single market directives” insert “or the emission allowance auctioning regulation”.

(7) In section 168(4)(j)(b) (appointment of persons to carry out investigations in particular cases), insert at the end “or by the emission allowance auctioning regulation”.

(8) In section 205(c) (public censure), after “the UCITS directive” insert “or by the emission allowance auctioning regulation”.

(9) In section 206(1)(d) (financial penalties), after “the UCITS directive” insert “or by the emission allowance auctioning regulation”.

(10) In section 206A(2)(e) (suspending permission to carry on regulated activities), in the definition of “relevant requirement”, omit the word “or” before paragraph (e), and at the end of that paragraph, insert—

“; or

(f) by the emission allowance auctioning regulation”.

(11) In section 380(6)(a)(i)(f) (injunctions), after “the UCITS directive” insert “or by the emission allowance auctioning regulation”.

(12) In section 382(9)(a)(i)(g) (restitution orders), after “the UCITS directive” insert “or by the emission allowance auctioning regulation”.

(13) In section 384(7)(a)(h) (power of Authority to require restitution), after “the UCITS directive” insert “or by the emission allowance auctioning regulation”.

(14) In section 417(1)(i) (definitions), in the definition of “investment services and activities”, for paragraphs (a) and (b) substitute—

“(a) Chapter VI of Commission Regulation 1287/2006 of 10 August 2006(j);

(b) Article 52 of Commission Directive 2006/73/EC of 10 August 2006(k); and

(c) Article 6(5) of the emission allowance auctioning regulation;”.

(a) Section 66(2) was amended by S.I. 2007/126 and 2011/1613.

(b) Paragraph (j) was inserted by S.I. 2007/126.

(c) Section 205 was amended by S.I. 2007/126 and 2011/1613.

(d) Section 206(1) was amended by S.I. 2007/126 and 2011/1613.

(e) Section 206A was inserted by section 9 of the Financial Services Act 2010 c. 28, and subsection (2) was amended by S.I. 2011/1613.

(f) Paragraph (a)(i) was amended by S.I. 2007/126 and 2011/1613.

(g) Paragraph (a)(i) was amended by S.I. 2007/126 and 2011/1613.

(h) Subsection 7(a) was amended by S.I. 2007/126 and 2011/1613.

(i) The definition of “investment services and activities” was inserted by S.I. 2007/126.

(j) Commission Regulation (EC) No 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive; OJ L 241, 2.9.2006, p. 1.

(k) Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive OJ L 241, 2.9.2006, p. 26.

(15) In section 418 (carrying on regulated activities in the United Kingdom), after subsection (6), insert—

“(7) For the purposes of subsection (2)(b) and (c), the emission allowance auctioning regulation is a single market directive.”

(16) In section 425(1)(a)(a) (expressions relating to authorisation elsewhere in the single market), after ““EEA State”,” insert ““emission allowance auctioning regulation”,”.

(17) In Schedule 1, paragraph 6(b)(monitoring and enforcement)—

(a) in sub-paragraph (1), after “under this Act, insert “by the emission allowance auctioning regulation”;

(b) in sub-paragraph (3), after “under this Act”, insert “, the emission allowance auctioning regulation,”.

Amendment of Schedule 3 to the Financial Services and Markets Act 2000

4.—(1) Schedule 3 to the Financial Services and Markets Act 2000 (EEA passport rights) is amended as follows.

(2) After paragraph 4C (the market in financial instruments directive)(c), insert—

“The emission allowance auctioning regulation

4D. “The emission allowance auctioning regulation” means Commission Regulation (EU) No 1031/2010 of 12 November 2010 on the timing, administration and other aspects of auctioning of greenhouse gas emission allowances pursuant to the emission allowance trading directive.”.

(3) In paragraph 5 (EEA firm)—

(a) at the end of sub-paragraph (e), omit “or”;

(b) at the end of sub-paragraph (f)(d), insert—

“; or

(g) a person who has received authorisation under Article 18.2 of the emission allowance auctioning regulation.”.

(4) In paragraphs 6(b)(e) (EEA authorisation), 7(b) (EEA right), 9 (home state regulator) and 11 (host state regulator), after “single market directive” insert “or, as the case may be, the emission allowance auctioning regulation”.

(5) In paragraph 12 (firms qualifying for authorisation), after sub-paragraph (6)(f), insert—

“(7) An EEA firm which falls within paragraph 5(a) or (b) but does not qualify for authorisation under sub-paragraph (1) or (2) qualifies for authorisation under this sub-paragraph if it—

(a) has received authorisation from its home state regulator under Article 18.3 of the emission allowance auctioning regulation; and

(b) is seeking to provide services in the United Kingdom in the exercise of the EEA right arising under that provision.

(8) An EEA firm which falls within paragraph 5(g) qualifies for authorisation.

(9) Sub-paragraph (2) does not apply to an EEA firm which falls within paragraph 5(a), (b) or (g), and only provides services in the exercise of its right under Article 18 of the emission allowance auctioning regulation.”.

(a) Paragraph (a) was substituted by S.I. 2003/2066, and amended by S.I. 2004/3379; 2006/2975; 2007/126 and 2007/3253.

(b) Paragraphs 6(1) and (3) were each amended by S.I. 2007/126 and 2011/1613.

(c) Paragraph 4C was inserted by S.I. 2006/2975.

(d) Sub-paragraph (f) was substituted by S.I. 2011/1613.

(e) Paragraph 6 was substituted by S.I. 2003/1473.

(f) Sub-paragraph (6) was inserted by S.I. 2007/3253.

- (6) In paragraph 14 (services), in sub-paragraph (4), in the definition of “host state rules”—
- (a) in paragraph (a), after “single market directive” insert “or the emission allowance auctioning regulation”, and
 - (b) in paragraph (b), after “that directive” insert “or that regulation”.
- (7) In paragraph 15(1A)(a) (grant of permission), for “paragraph 15A(3)” substitute “paragraphs 15A(3) and 15ZA(1)”.
- (8) After paragraph 15, insert—

“Grant of permission: bidding for emission allowances

15ZA.—(1) On qualifying for authorisation as a result of paragraph 12(1) or (2), a firm has permission to receive, transmit or submit a bid on behalf of its clients in the exercise of its rights under Article 18.3 of the emission allowance auctioning regulation if it has received authorisation under that provision from its home state regulator.

(2) Permission under sub-paragraph (1) is to be treated as being on terms equivalent to those appearing in the authorisation granted to the firm under Article 18.3 of the emission allowance auctioning regulation.

(3) A firm which qualifies for authorisation as a result of paragraph 12(7) has permission to receive, transmit and submit a bid on behalf of its clients in the exercise of its rights under Article 18.3 of the emission allowance auctioning regulation.

(4) A firm which qualifies for authorisation as a result of paragraph 12(8) has permission to receive, transmit and submit a bid on its own account or on behalf of clients of its main business under Article 18.2 of the emission allowance auctioning regulation.

(5) The permissions referred to in sub-paragraphs (3) and (4) are to be treated as being on terms equivalent to those appearing in the authorisation granted to the firm under Article 18.2 or 18.3 of the emission allowance auctioning regulation.”.

- (9) In paragraph 20 (services)—
- (a) in sub-paragraph (1)(b), for “sub-paragraph (4D)” substitute “sub-paragraphs (4D) and (4E)”;
 - (b) after sub-paragraph (4D)(c), insert—

“(4E) This paragraph does not apply to a UK firm having an EEA right which is subject to the conditions of the emission allowance auctioning regulation.”.

Amendment of the Financial Services and Markets Act 2000 (Professions) (Non-exempt Activities) Order 2001

5. In article 4 (activities to which exemption from the general prohibition does not apply) of the Financial Services and Markets Act 2000 (Professions)(Non-exempt Activities) Order 2001(d), after paragraph (c), insert—

“(ca) article 24A (bidding in emissions auctions);”.

Amendment of the Money Laundering Regulations 2007

- 6.**—(1) The Money Laundering Regulations 2007(e) are amended as follows.
- (2) In regulation 3(3) (application of the regulations), after paragraph (h), insert—

(a) Paragraph 15(1A) was inserted by S.I. 2003/2066.
 (b) Sub-paragraph (1) was amended by S.I. 2007/3253.
 (c) Sub-paragraph (4D) was inserted by S.I. 2007/3253.
 (d) S.I. 2001/1227, amended by S.I. 2001/3650, 2002/682, 2004/2737, and 2006/1969.
 (e) S.I. 2007/2157, amended by S.I. 2011/99, 2011/2699 and 2011/2833; there are other amending instruments but none is relevant.

“(i) a person falling within Article 2(1)(i) of the markets in financial instruments directive, when bidding directly in auctions under the emission allowance auctioning regulation on behalf of clients of the person’s main business.”

(3) In regulation 23(1)(a) (supervisory authorities), after paragraph (vi), insert—

“(vii) persons falling within Article 2(1)(i) of the markets in financial instruments directive;”.

Amendment of the Recognised Auction Platform Regulations 2011

7.—(1) The Recognised Auction Platform Regulations 2011(a) are amended as follows.

(2) In regulation 5(6)(a) (procedure), for “its intention to do so” substitute “its decision”.

(3) After regulation 5, insert—

“Power to impose civil penalties

5A.—(1) If the Authority considers that a recognised auction platform has contravened any requirement in Article 20(7), 21(1) or (2), or 54 of the emission allowance auctioning regulation, it may impose upon on the auction platform, or on any officer of the auction platform who has been knowingly concerned in the contravention, a penalty of such amount as it considers appropriate, and for this purpose, “appropriate” means effective, proportionate and dissuasive.

(2) The Authority must not impose a penalty on a person under paragraph (1) where there are reasonable grounds for it to be satisfied that the person took all reasonable steps and exercised all due diligence to ensure that the requirement was complied with.

(3) In deciding whether a person has failed to comply with the requirements referred to in paragraph (1), the Authority must consider whether the person concerned followed any relevant guidance issued by the Authority.

(4) If the Authority is entitled to impose a penalty on a person under this regulation in respect of a particular matter, it may, instead of imposing a penalty in respect of that matter, publish a statement censuring the person.

(5) A penalty under this regulation is payable to the Authority.

Procedure for civil penalties

5B.—(1) If the Authority proposes to take action against a person under regulation 5A, it must give that person a warning notice.

(2) A warning notice about a proposal to impose a penalty must state the amount of the proposed penalty.

(3) A warning notice about a proposal to publish a statement must set out the terms of the proposed statement.

(4) If the Authority decides to take action against a person under regulation 5A, it must without delay give the person a decision notice.

(5) A decision notice about the imposition of a penalty must state the amount of the penalty.

(6) A decision notice about the publication of a statement must set out the terms of the statement.

(7) If the Authority decides to take action against a person under regulation 5A, that person may refer the matter to the Tribunal.

(a) S.I. 2011/2699.

(8) Sections 387 to 391, 393 and 394 apply to notices given in accordance with this regulation.”.

PART 4 REVIEW

Review

- 8.—(1) Before the end of the review period, the Treasury must from time to time—
- (a) carry out a review of the amendments made by this Order,
 - (b) set out the conclusions of the review in a report, and
 - (c) publish the report.
- (2) In carrying out the review the Treasury must, so far as it is reasonable, have regard to how the emission allowance auctioning regulation is implemented in other Member States.
- (3) The report must in particular—
- (a) set out the objectives intended to be achieved by the amendments to the regulatory system established by this Order,
 - (b) assess the extent to which those objectives are achieved, and
 - (c) assess whether those objectives remain appropriate and, if so, the extent to which they could be achieved with a system that imposes less regulation.
- (4) The first report under this article must be published before the end of the period of five years beginning with the day on which this Order comes into force.
- (5) Reports under this article are afterwards to be published at intervals not exceeding five years.

	<i>Name</i>
	<i>Name</i>
Date	Two of the Lords Commissioners of Her Majesty’s Treasury

EXPLANATORY NOTE

(This note is not part of the Order)

This Order implements the requirement in Article 18 of Commission Regulation (EU) 1031/2010 of 12 November 2010 on the timing, administration and other aspects of auctioning of greenhouse gas allowances (OJ L 302, 18.11.2010, p.1) (“the emission allowance auctioning regulation”) for the United Kingdom to have enacted legislation enabling the Financial Services Authority (“the FSA”) to authorise certain categories of people to make them eligible to bid in auctions of emissions allowances on their own account or on behalf of clients, and related provisions in Articles 6(5) and 59 of that Regulation.

Article 2 amends the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (S.I. 2001/544) to make bidding in auctions of emissions allowances a new regulated activity, and to provide for exclusions from that activity. It also makes related amendments to that Order.

Article 3 amends the Financial Services and Markets Act 2000 (c.8) to allow the FSA to exercise its powers in relation to a person who is authorised to provide bidding services and makes related amendments.

Article 4 amends Schedule 3 to the Financial Services and Markets Act 2000 to provide for passporting rights under the emission allowance auctioning regulation in relation to bidding services.

Article 5 amends the Financial Services and Markets Act 2000 (Professions) (Non-exempt Activities) Order 2001 (S.I. 2001/1227).

Article 6 amends the Money Laundering Regulations 2007 so that a person falling within Article 2(1)(i) of Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments of 20 April 2004 (OJ L 145, 20.4.2004, p1) must comply with the requirements of those Regulations when bidding directly, on behalf of clients, in auctions of emissions allowances.

Article 7 amends the Recognised Auction Platforms Regulations 2011 (S.I. 2011/2699) (“the Regulations”) to clarify what notice must be given once the Authority has taken a decision in relation to a recognition order, direction or revocation order, and to ensure that that the Authority has the same power to impose civil penalties for contraventions of requirements in Articles 20(7), 21(1) or (2) or 54 of the emission allowance auctioning regulation that it would have in relation to regulation 42 of the Money Laundering Regulations 2007. It also amends the Regulations to provide for the procedure when this power is exercised.

Article 8 requires the Treasury to review the operation and effect of this Order within five years after it comes into force and within every five years after that. Following a review it will fall to the Treasury to consider whether the Order should remain as it is, or be revoked or be amended. A further instrument would be needed to revoke the Order or to amend it.

An Impact Assessment of the effect that this Order will have on the costs of business and the voluntary sector is available on HM Treasury’s website (hm-treasury.gov.uk) and is published with the Explanatory Memorandum alongside this Order on the legislation.gov.uk website.

B

Draft Order amending the Terrorism Act 2000 and the Proceeds of Crime Act 2002

B.1 The following pages contain the draft statutory instruments for the Terrorism Act 2000 and Proceeds of Crime Act 2002 (Business in the Regulated Sector) Order 2012.

2012 No. []

PREVENTION AND SUPPRESSION OF TERRORISM

PROCEEDS OF CRIME

The Terrorism Act 2000 and Proceeds of Crime Act 2002
(Business in the Regulated Sector) Order 2012

<i>Made</i>	- - - -	***
<i>Laid before Parliament</i>		***
<i>Coming into force</i>	- -	***

The Treasury make the following Order in exercise of the powers conferred on them by paragraph 5 of Schedule 3A to the Terrorism Act 2000(a) and paragraph 5 of Schedule 9 to the Proceeds of Crime Act 2002(b).

Citation and commencement

1. This Order may be cited as the Terrorism Act 2000 and Proceeds of Crime Act 2002 (Business in the Regulated Sector) Order 2012 and comes into force on [].

Amendment of Schedule 3A to the Terrorism Act 2000

2. In paragraph 1(1) (business in the regulated sector) of Schedule 3A to the Terrorism Act 2000(c), after sub-paragraph (s) insert—

“(t) bidding directly, on behalf of clients, in auctions of emissions allowances under the Emission Allowance Auctioning Regulation.”.

Amendment of Schedule 9 to the Proceeds of Crime Act 2002

3. In paragraph 1(1) (business in the regulated sector) of Schedule 9 to the Proceeds of Crime Act 2002(d), after sub-paragraph (s) insert—

“(t) bidding directly, on behalf of clients, in auctions of emissions allowances under the Emission Allowance Auctioning Regulation.”.

(a) 2000 c.11. Schedule 3A was inserted by the Anti-terrorism, Crime and Security Act 2001 (c.24), section 3, Schedule 2, Part 3, paragraphs 5(1) and (6).
(b) 2002 c. 29.
(c) Part 1 of Schedule 3A was substituted by S.I. 2007/3288. Paragraph 1 was amended by S.I. 2008/948; S.I. 2011/99 and 2011/2701.
(d) Part 1 of Schedule 9 was substituted by S.I. 2007/3287. Paragraph 1 was amended by S.I. 2008/948, S.I. 2011/99 and S.I. 2011/2701.

Review

4.—(1) The Treasury must from time to time—

- (a) carry out a review of articles 2 and 3,
- (b) set out the conclusions of the review in a report, and
- (c) publish the report.

(2) In carrying out the review the Treasury must, so far as is reasonable, have regard to how Commission Regulation (EU) No. 1031/2010 of 12 November 2010 on the timing, administration and other aspects of auctioning of greenhouse gas emission allowances pursuant to Directive 2003/87/EC of the European Parliament and of the Council establishing a scheme for greenhouse gas emission allowances trading within the Community^(a) (which is implemented in part by means of articles 2 and 3 of this Order) is implemented in other member States.

(3) The report must in particular—

- (a) set out the objectives intended to be achieved by articles 2 and 3,
- (b) assess the extent to which those objectives are achieved, and
- (c) assess whether those objectives remain appropriate and, if so, the extent to which they could be achieved with a system that imposes less regulation.

(4) The first report under this article must be published before the end of the period of five years beginning with the day on which this Order comes into force.

(5) Reports under this article are afterwards to be published at intervals not exceeding five years.

	<i>Name</i>
	<i>Name</i>
Date	Two of the Lords Commissioners of Her Majesty's Treasury

EXPLANATORY NOTE

(This note is not part of the Order)

This Order amends the definition of a business in the regulated sector for the purposes of Part 3 of the Terrorism Act 2000 (c.11) (terrorist property) and Part 7 of the Proceeds of Crime Act 2002 (c.29) (money laundering) by adding the activity of bidding on behalf of others in an auction of emission allowances. Those Parts contain provisions relating to the reporting of suspicious activity, including requirements and offences specific to such businesses.

The framework for the auctioning of emissions allowances is set out in Commission Regulation (EU) No. 1031/2010 of 12 November 2010 on the timing, administration and other aspects of auctioning of greenhouse gas emission allowances (OJ No. L 302, 18.11.10, p.1). The Regulation requires that persons wishing to bid on behalf of others in an auction of emissions allowances must be authorised to do so. In order to be authorised, such persons must satisfy certain conditions, one of which is that they comply with the requirements of national legislation implementing the Third Money Laundering Directive. The Third Money Laundering Directive is implemented in part by Part 3 of the Terrorism Act 2000 and Part 7 of the Proceeds of Crime Act 2002.

Article 4 requires the Treasury to review the operation and effect of this Order and publish a report within five years after it comes into force and within every five years after that.

(a) OJ No. L 302, 18.11.10, p.1.

An Impact Assessment of the effect that this Order will have on the costs of business and the voluntary sector is available on HM Treasury's website (hm-treasury.gov.uk) and is published with the Explanatory Memorandum alongside this Order on the legislation.gov.uk website.

C

Impact assessment

C.1 The following pages contain the impact assessment for the proposals set out in this consultation document.

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2012	PV Base Year 2012	Time Period Years 9	Net Benefit (Present Value (PV)) (£m)		
			Low: n/a	High: n/a	Best Estimate: -£0.13

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	N/A	N/A	N/A
High	N/A	N/A	N/A
Best Estimate	0.017	0.017	0.13

Description and scale of key monetised costs by 'main affected groups'

There will be one-off costs to relevant persons of completing an application for Financial Services Authority authorisation and annual costs of refreshing the bidders authorised status. The total one off costs are estimated to be £17,000. The total annual costs are estimated to be £17,000 per annum. These figures are based on current auctioning data and FSA regulatory experience.

Other key non-monetised costs by 'main affected groups'

N/A

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	N/A	N/A	N/A
High	N/A	N/A	N/A
Best Estimate	N/A	N/A	N/A

Description and scale of key monetised benefits by 'main affected groups'

The benefits stemming from this increased regulation of bidders in carbon auctions are difficult to quantify. They will essentially be the ability for certain firms to provide services to their clients in relation to auctions of emissions allowances and increased confidence in the primary carbon market.

Other key non-monetised benefits by 'main affected groups'

The carbon market is still in its infancy. Recent challenges faced by the market have included fraudulent attacks on the secondary market and phishing scams attacking the registry system (the accounts that hold the allowances). These have threatened to undermine confidence in this emerging market. There are several work streams at EU level to bolster security in the carbon market. These regulatory changes implement a more robust regulatory framework for the primary carbon market.

Key assumptions/sensitivities/risks	Discount rate (%)	3.5
The key assumption is around the number of firms that will seek FSA authorisation and that these firms will already be regulated by the FSA. Assumptions have also been made on the time it will take to complete an application. These assumptions will be tested during the consultation process.		

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:		In scope of OIOO?	Measure qualifies as
Costs: 0.017	Benefits: N/A	No	N/A
Net: -0.017			

Evidence Base (for summary sheets)

The policy objective is to ensure that relevant UK based persons are able to bid in auctions of emission allowances across Europe, and relevant EU persons are able to bid in UK auctions, under the regulatory framework set out in the European Auctioning Regulation (AR). This will help ensure auction participation and preserve and strengthen London's position at the heart of the carbon market, of which London currently enjoys an 80% global share. The changes will be welcomed by market participants and implement the EU requirements necessary to allow certain persons to bid to auctions of emissions allowances.

The policy context

The EU Emissions Trading System

The EU Emissions Trading System (EU ETS) is at the heart of UK Government policy to tackle climate change. The system covers sectors responsible for around half of the UK's carbon dioxide emissions. The EU ETS is expected to deliver annual carbon savings of 51MtCO₂ in 2020, a reduction in the emissions of the power sector and heavy industry of 22 percent based on 2008 levels.

The EU ETS works on a 'cap and trade' basis. A cap is set on EU Member States' emissions, which declines over time. Emissions allowances equal to each year's cap are then issued and allocated to sectors covered by the system. Allowances can be allocated for free or auctioned by national governments.

Levels of auctioning in the EU ETS are set to rise dramatically in phase III (from 2013). This is reflected in the forecast quadrupling of UK revenues from auctioning. The EU regulatory framework for auctions has been strengthened to reflect this large increase in auctioning. This includes requiring certain bidders in the auctions to be authorised to bid by the Financial Services Authority (FSA).

It is worth noting that aviation will be joining the EU ETS from 2012. These changes also apply to certain bidders in auctions of aviation emissions allowances.

Phase III of the EU Emissions Trading System

The AR sets out the regulatory framework for auctioning emissions allowances during phase III and aviation allowances in 2012. It requires EU Member States to implement certain elements of the regulation to allow relevant categories of persons to bid in auctions of emissions allowances across the EU.

Member State implementation is required to allow credit institutions,¹ authorised by the FSA under the Capital Requirements Directive (2006/48/EC) and investment firms, authorised by the FSA under the European Markets in Financial Instruments Directive (MiFID) to bid in the auctions on behalf of their clients. These changes are also required to allow a further category of persons, currently exempt from MiFID (mainly commodities brokers), to bid in auctions on their own account or on behalf of others.

Implementing these elements of the AR will result in the FSA gaining powers to authorise relevant persons to bid in auctions of emissions allowances. This involves amendments to the secondary legislation related to the Financial Services and Markets Act (2000) and minor amendments to the Act itself.

The options considered

There are three possible options:

- Do nothing
- Implement the minimum requirements
- Implement changes that go slightly beyond the minimum requirements with regards to certain non-UK bidders (the proposed option)

Do nothing

Not implementing the regulatory framework required by EU regulations would prevent relevant UK based persons from bidding in auctions of emissions allowances across Europe. This would impose an unjustified constraint on the activities of some UK based persons such as banks and investment banks and damage London's position at the heart of the carbon market.

¹ Primarily banks and investment banks

Implement the minimum requirements

Implementing the minimum requirements would result in the FSA possessing different enforcement powers for certain offshore firms. While the usual powers would be applicable to EU investment firms and credit institutions the FSA would be without these powers with regards to MIFID-exempt EU firms. Therefore this is not the recommended option.

Implement changes that go slightly beyond the minimum requirements with regards to certain non-UK bidders (the favoured option)

This is the favoured option and is explained in detail below.

The proposed approach

The Financial Services and Markets Act changes

The AR identifies the following broad groups as persons eligible to apply for admission to bid in auctions of carbon emission allowances:

- (i) Operators of installations or aircraft operators covered by the emissions trading scheme (essentially users of emissions allowances who need to buy allowances for compliance purposes) or groups of such operators or public bodies that control them
- (ii) Investment firms or credit institutions authorised under the MiFID or the Capital Requirements Directive (2006/48/EC)
- (iii) Persons who are covered by the exemption from MiFID for dealing on own account in financial instruments where this is ancillary to their main business

Entities under (i) above can bid without authorisation, but for entities falling within (ii) where auctioned products are not financial instruments, and (iii), their eligibility to bid depends on the Member State in which firms are located having enacted legislation enabling the relevant competent authority in that Member State (in the UK, the FSA) to authorise the firms to bid on their own account (for entities falling within (iii)) or on behalf of clients (for entities falling within (ii) and (iii)).

It is necessary to make some changes to provisions regarding regulated activities in the Financial Services and Markets Act 2000 and related legislation to ensure that all the groups identified in the AR are in a position to be able to apply for admission to bid in auctions. The approach taken has been to keep changes to a minimum. The reception, transmission and submission (whether as agent or principal) of a bid at an auction of investments is made a specified activity in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 with appropriate exemptions, e.g. for (i) above. Changes are also made to allow the FSA to exercise its powers in relation to a person who is authorised to provide bidding services.

Amendment to the Recognised Auction Platform Regulations 2011

New provisions are added to the Recognised Auction Platform Regulations 2011 to give effect to requirements in the AR for the competent authority to have the power (and the procedure to be applied when exercising the power) to impose civil penalties for contraventions by auction platforms in certain circumstances relating to grounds for refusal or suspension of admission to bid, and monitoring the relationship with bidders.

Changes to the Money Laundering Regime

Article 59 of the AR sets out rules for persons authorised to bid on behalf of others or on their own account. The Regulations provide that competent national authorities are responsible for authorising such persons to bid, and for monitoring their compliance with the rules. Amongst others, it provides that the authorities shall only authorise such persons where they comply with the requirements of the national legislation transposing the EU Third Money Laundering Directive. In the UK the relevant national legislation is the Money Laundering Regulations 2007 (MLRs), Schedule 3A to the Terrorism Act 2000 and Schedule 9 to the Proceeds of Crime Act 2002.

Under the AR, most persons or firms eligible to apply to bid in auctions of emissions allowances – investment firms and credit institutions – are already subject to the Money Laundering Regulations. However the category of businesses currently subject to an exemption under Article 2(1)(i) of the Markets in Financial Instruments Directive (MiFID) are not covered. These firms are those for which the

provision of commodity derivatives services, while connected to their core business, is not their core business, so they currently benefit from the exemption.

In order to allow these specific MiFID-exempt firms to bid in auctions of emissions allowances, they must be subject to anti-money laundering requirements.

In order to implement this option, the Government proposes to legislate so that MiFID-exempt firms who want to apply to bid on their own account or on behalf of others have to comply with the requirements of the MLRs when carrying out those activities.

This will provide legal certainty with regard to the extent and nature of the bidder's anti-money laundering obligations. Under this option all firms falling under MiFID article 2(1)(i) which engage in bidding for emission auctions would need to comply with all the requirements set out in the MLRs including on Customer Due Diligence, record keeping and monitoring of transactions. They would be subject to anti-money laundering supervision and to the range of regulatory and criminal sanctions related to the MLRs. Under this arrangement, the FSA will have statutory powers and the mandate to supervise and sanction accordingly in line with the current arrangement under the MLRs.

This would create a level playing field in that MiFID-exempt bidders failing to comply with the MLRs will be subject to similar supervision arrangements and sanctions as others non-MiFID exempt bidders which are already supervised and subject to all MLRs obligations.

Micro organisations

Micro organisations have not been excluded as the EU regulation does not provide any basis for us to do so. In practice we consider it highly unlikely that any micro firm would ever wish to become authorised in auctions of emissions allowances as it would be contrary to all our experience. In general we only expect much larger organisations to apply for authorisation.

Going slightly beyond the minimum EU requirements with regards to certain non-UK bidders

The proposed approach implements the minimum EU requirements except in the area of FSA powers where the proposal is to go slightly beyond the minimum requirements with regards to certain non-UK bidders. A strict reading of the AR would result in the FSA having its usual powers with regards to firms from the rest of the EU falling within categories (i) and (ii) above but without powers regarding EU firms falling within category (iii). It is not desirable for the FSA to have different powers regarding EU firms engaging in the same activity but dependent on the specific nature of the firm in question. Therefore we propose going slightly beyond the minimum EU requirements. This proposal can be tested during the consultation period.

Monetised and non-monetised costs and benefits of implementing the proposed approach

Costs

These costs will only apply to relevant persons who wish to bid in auctions of emissions allowances. The majority of these persons are already authorised by the FSA for their other activities and therefore the additional costs imposed by these new regulations will be marginal (including the costs imposed on the FSA).

It is worth noting that the relevant persons will only seek authorisation to bid in auctions of emissions allowances if they consider it will provide a financial return (through trading allowances or providing bidding services to their clients). They are not required to purchase allowances for compliance purposes.

Number of persons

The AR sets out who the relevant persons are. In broad terms they are investment firms authorised as such by the FSA, credit institutions authorised as such by the FSA and certain categories of persons that are specifically exempted from regulation by the EU framework (such as commodities brokers).

Data from the FSA show there are around 2,500 investment firms and around 100 credit institutions currently authorised by the FSA. Estimating the number of persons specifically exempted from regulation under MiFID is more difficult as we do not hold this data. Nevertheless, based on our knowledge of regulated firms and our operational experience of auctioning in the current phase of the EU ETS, we assume that in total only around 20 firms will seek authorisation to bid in auctions of emissions allowances. This is because:

- Only around 90 of the regulated firms are involved in commodities trading of any type, of which, 50 are specialised in non-carbon commodities. Based on our experience in auctions of emissions

allowances we judge only a proportion of the remainder will actually wish to bid in the auctions on behalf of clients.

- Estimating the number of firms exempt from regulation under MiFID is more challenging. Nevertheless all bidders in the current UK EU ETS auctions are authorised by the FSA or an overseas equivalent and we would not expect this to change in future auctions, although we will seek further evidence of whether this is likely to be the case during the consultation. Furthermore all compliance buyers will be able to access the auctions directly or through intermediaries. Therefore we do not expect any of these exempt firms to seek authorisation to bid in auctions of emissions allowances.

The assumption that only around 20 firms in total will seek authorisation to bid in auctions of emissions allowances will be tested and refined during the consultation process and the assessment of impacts updated as required.

One off costs

There will be one-off costs to relevant persons of completing an application to become authorised by the FSA to bid in the auctions.

Our initial assessment is that the fee charged to the applicant (which broadly reflects the cost borne by the FSA) to authorise a firm that is already regulated by the FSA to carry out their other activities will be around £250. It would be unlikely to take the firm more than one day to complete the application at an assumed cost of around £600. It is not anticipated that professional advice would be needed. Again these assumptions will be tested during the consultation process.

The cost of authorising a firm that is not already regulated by the FSA to carry out their other activities would be around £1,000 in FSA fees and several days work within the firm. Nevertheless, as stated above, we do not expect any unregulated firms to apply for authorisation to bid in the auctions. As mentioned previously we will use the consultation process to test this assumption.

Therefore the total one-off costs to all 20 businesses (assuming that they are applying only for a variation of existing permissions) of applying to become authorised to bid in auctions of emissions allowances are estimated to be £17,000.

The FSA fees are estimates at this stage. The FSA will be consulting on the exact activities they will need to carry out and the fees they will charge. This impact assessment will consequently be updated as necessary.

Ongoing costs

It is expected that authorised bidders will need to reaffirm their status annually. This would be a similar process to the initial authorisation of the firm and our estimate of the costs reflects this. As set out above, our initial assessment of the costs is that they will be no more than £250. Again we estimate it would likely take the firm one day to complete the necessary work with an assumed cost of around £600. Again these assumptions will be tested during the consultation process.

Therefore the total ongoing annual costs to all 20 businesses of refreshing their authorisation to bid in auctions of emissions allowances are estimated to be no more than £17,000.

Total direct monetised costs

The total monetised costs are therefore estimated to be £17,000 in each year.

Non-monetised costs

We do not expect any non-monetised costs as a result of these changes.

Assumptions

As set out above the key assumption is around the number of firms that will seek FSA authorisation and that these firms will already be regulated by the FSA. Assumptions have also been made on the time it will take to complete an application. These assumptions will be tested during the consultation process.

Benefits

The benefits stemming from this increased regulation of bidders in carbon auctions are difficult to quantify. They will essentially be increased confidence in the carbon market and the ability for certain firms to provide services to their clients in relation to auctions of emissions allowances.

Relatively speaking the carbon market is still in its infancy. Recent challenges faced by the market have included fraudulent attacks on the secondary market and phishing scams attacking the registry system (the accounts that hold the allowances). These have threatened to undermine confidence in this emerging market. There are several work streams at EU level to bolster security in the carbon market. These regulatory changes implement a more robust pan-European regulatory framework with regards to bidders in the primary carbon market. It has not been possible to monetise these benefits.

The other key benefit and the reason these changes are likely to be welcomed by stakeholders are because they will enable UK-based persons to provide services to their clients in relation to auctions of emissions allowances by being able to bid on their clients' behalf. These are services that these firms currently provide to their clients which they would be prevented from providing without these changes. It has also not been possible to monetise these benefits although any decision to become authorised by the FSA to bid on behalf of others in auctions of emissions allowances would be a commercial decision for the firm.

These benefits will benefit the UK by helping to preserve and strengthen its central role in the carbon market. The UK is a world leader in the carbon market with an 80% global share.

Annual profile of direct costs of the favoured option – (£m) constant prices

Costs have been set out to 2020 as this is when the relevant phase of the EU ETS ends. EU rules regarding the next phase of the EU ETS have yet to be decided.

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Initial authorisation	0.017								
Annual reaffirmation of authorisation		0.017	0.017	0.017	0.017	0.017	0.017	0.017	0.017
Total costs	0.017								

Impacts on competition

As these changes will increase those eligible to bid in the auctions of emissions allowances it is anticipated these changes will increase competition.

Equality Impact

There will not be any impacts on equality.

Implementation plan

The FSA is the delivery body for these changes. We have been working closely with them to ensure the proposed approach works effectively. The FSA will consulting on the necessary changes to their rulebook in the spring of 2012.

We are aiming to implement these changes by end Q2 2012 in order for them to be in place prior to the relevant auctions being held.

D

Summary of questions

Box D.1: Summary of questions

Questions on the amendments in relation to the Financial Services and Markets Act 2010

- 1 Do you agree that the approach proposed gives effect to the AR in an effective and proportionate manner?
- 2 Do you agree there should be a new regulated activity for all categories of bidders, including credit institutions and investment firms, which covers the reception, transmission or submission of a bid for all auctioned products, including auctioned products which are financial products within the meaning of MiFID?
- 3 Do you agree that the approach for MiFID-exempt firms is the right one?
- 4 Have you any other comments about the changes to FSMA and related legislation?
- 5 Do you agree with the assessment of the impacts of these proposals (found in Annex C)?

Questions on the amendment to the Recognised Auction Platform Regulations 2011

- 6 Do you have any comments on the proposed amendments to the Recognised Auction Platform Regulations 2011?

Questions on Anti-Money Laundering compliance

- 7 Do you agree that the Government's approach is a fair and transparent solution to ensure MLR compliance by MiFID-exempt firms under article 2(1)(i)?
- 8 Do you have any comments on the proposed amendments to the anti-money laundering legislation?
- 9 Do you agree with the assessment of the impacts of these proposals (found in Annex C)?

HM Treasury contacts

This document can be found in full on our website: <http://www.hm-treasury.gov.uk>

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