

Recognised Investment Exchanges

Chapter 4

Supervision

4.5 FCA supervision of action by UK RIEs under their default rules

4.5.1 **G** UK RIEs which, under their *rules*, have *market contracts* are required to have *default rules* enabling them (among other things) to take action in relation to a *member* who appears to be unable to meet his obligations in respect of one or more unsettled *market contracts*. The detailed *recognition requirements* relating to the *default rules* are set out in ■ REC 2.17.

4.5.2 **G** The *default rules* are designed to ensure that rights and liabilities between the defaulter and any counterparty to an unsettled *market contract* are discharged, and for there to be paid between the defaulter and each counterparty one net sum. The Companies Act 1989 contains provisions which protect action taken under *default rules* from the normal operation of insolvency law which might otherwise leave this action open to challenge by a *relevant office-holder*.

4.5.3 **G** The Companies Act 1989 also gives the FCA powers to supervise the taking of action under *default rules*. Under section 166 of the Companies Act 1989 (Powers of the appropriate regulator to give directions) (see ■ REC 4.5.4 G), the FCA may direct a UK RIE to take, or not to take, action under its *default rules*. Before exercising these powers the FCA must consult the UK RIE. The FCA may also exercise these powers if a *relevant office-holder* applies to it under section 167 of the Companies Act 1989 (Application to determine whether default proceedings to be taken) (see ■ REC 4.5.9 G).

4.5.4 **G** The Companies Act 1989: section 166

The FCA may issue a "positive" direction (to take action) under section 166(2)(a) of the Companies Act 1989:

Where in any case a [UK RIE] has not taken action under its default rules- if it appears to [the FCA] that it could take action, [the FCA may direct it to do so,

but under section 166(3)(a) of the Companies Act 1989:

Before giving such a direction the [FCA] shall consult the [UK RIE] in question; and [the FCA] shall not give a direction unless [the FCA] is satisfied, in the light of that consultation that failure to take action would involve undue risk to investors or other participants in the market, or that the direction is necessary having regard to the public interest in the financial stability of the United Kingdom, or that the direction is necessary to facilitate a proposed or possible use of a power under Part 1 of the Banking Act 2009 or in connection with a particular exercise of a power under that Part.

The FCA may issue a "negative" direction (not to take action) under section 166(2)(b) of the Companies Act 1989:

Where in any case a [UK RIE] has not taken action under its default rules - if it appears to the [FCA] that it is proposing to take or may take action, [the FCA] may direct it not to do so.

but under section 166(3)(b) of the Companies Act 1989:

Before giving such a direction the [FCA] shall consult the [UK RIE] in question; and the [FCA] shall not give a direction unless [the FCA] is satisfied, in the light of that consultation that the taking of action would be premature or otherwise undesirable in the interests of investors or other participants in the market, or that the direction is necessary having regard to the public interest in the financial stability of the United Kingdom, or that the direction is necessary to facilitate a proposed or possible use of a power under Part 1 of the Banking Act 2009 or in connection with a particular exercise of a power under that Part.

- 4.5.5** **G** Other than in exceptional circumstances, the FCA will consult with the Bank of England before exercising these powers.
- 4.5.6** **G** Under section 166(6) of the Companies Act 1989, a negative direction cannot be given if, in relation to the defaulter, either:
- (1) a bankruptcy order or an award of sequestration of the defaulter's estate has been made, or an interim receiver or interim trustee has been appointed; or
 - (2) a winding-up order has been made, a resolution for voluntary winding-up has been passed or an administrator, administrative receiver or provisional liquidator has been appointed;
- and any previous negative direction will cease to have effect on the making or passing of any such order, award or appointment.
- 4.5.7** **G** Under section 166(5) of the Companies Act 1989, a negative direction may be expressed to have effect until a further direction is given, which may either be a positive direction or a revocation of the earlier negative direction.
- 4.5.8** **G** Under section 166(7) of the Companies Act 1989, where a UK RIE has taken action either of its own accord or in response to a direction, the FCA may direct it to do or not to do specific things subject to these being within the powers of the UK RIE under its *default rules*. However,
- (1) where the UK RIE is acting in accordance with a direction given by the FCA to take action under section 166(2)(a) of the Act on the basis that failure to take action would involve undue risk to investors or other participants in the market, the FCA will not direct it to do or not to do specific things which the UK RIE has power to do under its *default rules*, unless the FCA is satisfied that this will not impede or frustrate the proper and efficient conduct of the default proceedings; and
 - (2) where the UK RIE has taken action under its *default rules* without being directed to do so, the FCA will not direct it to do or not to do

specific things which the *UK RIE* has power to do under its *default rules*, unless the *FCA* is satisfied that:

- (a) the direction will not impede or frustrate the proper and efficient conduct of the default proceedings; or
- (b) the direction is necessary:
 - (i) having regard to the public interest in the stability of the *UK financial system*;
 - (ii) to facilitate a proposed or possible use of a power under Part 1 of the Banking Act 2009 (special resolution regime); or
 - (iii) in connection with a particular exercise of a power under Part 1 of the Banking Act 2009.

Section 167 of the Companies Act 1989

4.5.9

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Where, in relation to a *member* (or *designated non-member*) of a *UK RIE* :

- (1) a bankruptcy order; or
- (2) an award of sequestration of his estate; or
- (3) an order appointing an interim receiver of his property; or
- (4) an administration or winding-up order; or
- (5) a resolution for a voluntary winding-up; or
- (6) an order appointing a provisional liquidator;

has been made or passed and the *UK RIE* has not taken action under its *default rules* as a result of this event or of the matters giving rise to it, a *relevant office-holder* appointed in connection with the order, award or resolution may make an application to the *FCA* under section 167 of the Companies Act 1989 (Application to determine whether default proceedings to be taken).

4.5.10

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The effect of an application under section 167 of the Companies Act 1989 is to require the *UK recognised body* concerned to take action under its *default rules* or to require the *FCA* to take action under section 166 of the Companies Act 1989 (see *REC 4.5.4G*).

4.5.11

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The procedure is that the *FCA* must notify the *UK recognised body* of the application and, unless within three *business days* after receipt of that notice, the *UK recognised body*:

- (1) takes action under its *default rules*; or
- (2) notifies the *FCA* that it proposes to take action forthwith; or
- (3) is directed to take action by the *FCA* under section 166(2)(a) of the Companies Act 1989;

the provisions of sections 158 to 165 of the Companies Act 1989 do not apply in relation to *market contracts* to which the *member* or *designated non-member* is a party or to anything done by the *UK recognised body* for the purpose of, or in connection with, the settlement of any *market contracts*.