EXPLANATORY MEMORANDUM TO

THE CENTRAL COUNTERPARTIES (AMENDMENT, ETC., AND TRANSITIONAL PROVISION) (EU EXIT) REGULATIONS 2018

2018 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by Her Majesty's Treasury and is laid before Parliament by Act.

2. Purpose of the instrument

2.1 This instrument is being made using powers in the European Union (Withdrawal) Act 2018 in order to address failures of retained European Union (EU) law to operate effectively and other deficiencies arising from the withdrawal of the United Kingdom from the European Union, and to make provision for the charging of fees in connection with the exercise of functions conferred upon the Bank of England (BoE) by these Regulations.

2.2 This instrument amends Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on Over the Counter derivatives, central counterparties and trade repositories ("EMIR") in relation to the recognition of third country central counterparties (CCPs) and makes consequential amendments and transitional provisions.

2.3 Explanations:

What did any relevant EU law do before exit day?

Under the European Market Infrastructure Regulation ('EMIR'), third country CCPs that intend to provide clearing services to clearing members or trading venues established in the EU must be recognised by the European Securities and Markets Authority (ESMA). ESMA can only recognise a third country CCP if various conditions are met. These include a requirement on the European Commission to determine that the legal and supervisory arrangements of the third country in which the CCP is established are equivalent to those set out in EMIR, and a requirement on ESMA to agree cooperation arrangements with the relevant third country regulatory authority.

Why is it being changed?

To ensure the retained EMIR operates effectively after the United Kingdom withdraws from the EU, various provisions must be in place. These include: transferring the equivalence and recognition functions to relevant United Kingdom authorities; and ensuring that all non-UK CCPs, including CCPs established in the EU, are considered as third country CCPs for the purpose of the United Kingdom's post exit-day third country regime for CCPs.

What will it now do?

This instrument does four things. Firstly, it addresses the deficiencies in Article 25 of retained EMIR by transferring ESMA's functions relating to the recognition of third

country CCPs to the Bank of England and amending Part 18 of FSMA where necessary to ensure a coherent UK regulatory framework.

The SI transfers the European Commission's function of determining whether third countries have an equivalent regulatory regime to the Treasury and revokes the Commission Implementing Acts that relate to third country equivalence under Article 25 of EMIR. The Bank of England may provide advice to the Treasury for this assessment. The Treasury expects that jurisdictions that have already been assessed as equivalent by the EU will also be found equivalent by the UK (as also set out by the Bank of England in letters to non-UK CCPs[1]). To ensure continuity of existing services until existing EU equivalence decisions have been transferred into UK law, the temporary recognition regime will provide a fall-back for non-UK CCPs to continue to provide services to the UK. Under this approach, the Bank of England can assess potential risks to UK financial stability while continuity of existing services can be ensured. In other areas of financial services regulation, the Treasury will preserve all existing equivalence decisions, through retaining Commission Implementing Acts to ensure that there is no disruption to the provision of existing services.

Secondly, in order for there to be a seamless continuation of services by non-UK CCPs (including CCPs established in the European Union) which currently provide clearing services in the United Kingdom, this instrument provides the Bank of England with powers to receive applications and assess and make decisions on the recognition of non-UK CCPs before exit day – with those decisions taking effect on exit day as if they were made under Article 25 EMIR (provided that the other conditions under retained Article 25 EMIR have also been satisfied). From exit day, a non-UK CCP will only be able to provide clearing services in the United Kingdom if it has been recognised by the Bank of England under that provision.

Thirdly, this instrument puts in place a 'Temporary Recognition' regime, enabling third country CCPs to continue their activities in the UK for a limited period after exit day if they are currently able to provide those activities in the European Union under EMIR, and have notified the Bank of England (before exit day) that they intend to continue doing so in the United Kingdom.

Fourthly, in order to enable the Bank to carry out work in relation to their transitional functions under part 6, the instrument enables the Bank to charge fees from non-UK CCPs that are providing services to the UK.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 The territorial application of this instrument includes Scotland and Northern Ireland.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is to the whole United Kingdom.

[1] https://www.bankofengland.co.uk/letter/2017/letter-to-ccps

4.2 The territorial application of this instrument is to the whole United Kingdom.

5. European Convention on Human Rights

5.1 The Economic Secretary to the Treasury (John Glen) has made the following statement regarding Human Rights:

"In my view the provisions of the Central Counterparties Financial Services Authorisation (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018 are compatible with the Convention rights."

6. Legislative Context

6.1 This instrument addresses certain failures and deficiencies arising from the withdrawal of the United Kingdom from the European Union in relation to EMIR, specifically in respect of the recognition of third country CCPs under Article 25.

6.2 Other failures and deficiencies in relation to EMIR are expected to be addressed in the Trade Repositories (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018 and the Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment) (EU Exit) Regulations 2018 which are also intended to be made in 2018 using powers in the European Union (Withdrawal) Act 2018.

7. Policy background

What is being done and why?

7.1 The UK will leave the EU on 29 March 2019. The UK and the EU have agreed the terms of an implementation period that will start on 29 March 2019 and last until 31 December 2020. This will provide time to introduce the new arrangements that will underpin the UK-EU future relationship, and provide valuable certainty for businesses and individuals. During the implementation period, common rules will continue to apply. The UK will continue to implement new EU law that comes into effect and the UK will continue to be treated as part of the EU's single market in financial services. This will mean that access to each other's markets will continue on current terms and businesses, including financial services firms, will be able to trade on the same terms as now until 31 December 2020. UK firms will need to comply with any new EU legislation that becomes applicable during the implementation period.

7.2 The government is seeking a deep and special future partnership with the EU, which should be greater in scope and ambition than any such agreement before and encompass financial services. Given the highly regulated nature of financial services, the volume of trade between UK and EU markets, and a shared desire to manage financial stability risks, the UK would need a stable process for maintaining equivalent regulatory outcomes as legislation evolves – including a system to resolve disagreements at regulatory and supervisory levels – alongside an open, collaborative relationship between supervisors that protects UK and EU financial systems and UK and EU taxpayers from financial stability risks.

7.3 While the government has every confidence that a deal will be reached and the implementation period will be in place, it has a duty to plan for all eventualities, including a 'no deal' scenario. The government is clear that this scenario is in neither the UK's nor the EU's interest, and the government does not anticipate it arising. To prepare for this unlikely eventuality, HM Treasury intends to use powers in the

European Union (Withdrawal) Act (EUWA) to ensure that the UK continues to have a functioning financial services regulatory regime in all scenarios.

7.4 The EUWA repeals the European Communities Act 1972 and converts into UK domestic law the existing body of directly applicable EU law (including EU Regulations). It also preserves UK laws relating to EU membership – e.g. legislation implementing EU Directives. This body of law is referred to as "retained EU law". The EUWA also gives ministers a power to prevent, remedy or mitigate any failure of EU law to operate effectively, or any other deficiency in retained EU law, through SIs. These contingency preparations for financial services legislation are sometimes referred to as 'onshoring'. These SIs are not intended to make policy changes, other than to reflect the UK's new position outside the EU, and to smooth the transition to this situation. The scope of the power is drafted to reflect this purpose and is subject to further restrictions, such as the inability to use the power to impose or increase taxation, or establish a public authority. The power is also time-limited and falls away two years after exit day.

7.5 Wherever practicable, the proposed approach is that the same laws and rules that are currently in place in the UK would continue to apply at the point of exit, providing continuity and certainty as we leave the EU. However, if the UK does not enter an implementation period, some changes would be required to reflect the UK's new position outside the EU from 29 March 2019.

7.6 In the unlikely scenario that the UK leaves the EU without a deal, the UK would be outside the EU's framework for financial services. The UK's position in relation to the EU would be determined by the default Member State and EU rules that apply to third countries at the relevant time. The European Commission has confirmed that this would be the case.

7.7 In light of this, the approach in this scenario cannot and does not rely on any new, specific arrangements being in place between the UK and the EU. As a general principle, the UK would also need to default to treating EU Member States largely as it does other third countries, although there are cases where a different approach would be needed including to provide for a smooth transition to the new circumstances.

7.8 HM Treasury published a document on 27 June 2018, which sets out in more detail HM Treasury's approach to financial services legislation under the European Union (Withdrawal) Act. (https://www.gov.uk/government/publications/financial-services-legislation-under-the-eu-withdrawal-act)

7.9 In a Written Statement on 20 December 2017 (HCWS382), HM Treasury announced its intention to grant CCP recognition powers to the Bank (https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2017-12-20/HCWS382/). This instrument implements that announcement.

7.10 Central Counterparties (CCPs) are financial institutions which firms use to reduce the risk arising from trades, including derivatives. The CCP guarantees that transactions will be honoured if the other party defaults. CCPs do this by standing between the parties of a trade, becoming the buyer to every seller and the seller to every buyer.

7.11 Under the European Market Infrastructure Regulation ('EMIR'), third country CCPs that intend to provide clearing services to clearing members or trading venues established in the EU must be recognised by the European Securities and Markets

Authority (ESMA). ESMA can only recognise a third country CCP if various conditions are met. These include a requirement on the European Commission to determine that the legal and supervisory arrangements of the third country in which the CCP is established are equivalent to those set out in EMIR, and a requirement on ESMA to agree cooperation arrangements with the relevant third country regulatory authority.

7.12 To ensure the retained EMIR operates effectively after the UK withdraws from the EU, various provisions must be in place. These include: transferring the equivalence and recognition functions to relevant UK authorities; and ensuring that all non-UK CCPs, including CCPs established in the EU, are considered as third country CCPs for the purpose of the UK's post exit-day third country regime for CCPs.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument is being made using the power in section 8 of the European Union (Withdrawal) Act 2018 in order to address failures of retained EU law to operate effectively or other deficiencies arising from the withdrawal of the United Kingdom from the European Union. The instrument is also made under paragraph 1 of Schedule 4, and paragraph 21 of Schedule 7 of the Act. In accordance with the requirements of that Act the Minister has made the relevant statements as detailed in Part 2 of the Annex to this Explanatory Memorandum.

9. Consolidation

9.1 There are currently no plans to consolidate the relevant legislation.

10. Consultation outcome

10.1 HM Treasury did not undertake a consultation on this instrument. We have engaged extensively with the Bank of England and Financial Conduct Authority to draft this legislation, and the measure covered by this SI was announced in December 2017, by HM Treasury (https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2017-12-20/HCWS382/) and the Bank of England (https://www.bankofengland.co.uk/news/2017/december/approach-to-authorisation-and-supervision-of-international-banks-insurers-central-counterparties.

11. Guidance

11.1 None.

12. Impact

12.1 The impact on business, charities or voluntary bodies is limited. Non-UK CCPs will require a legal expert to examine the new legislation, and will need to submit an application for recognition to the Bank of England. The new process will be broadly the same as the existing EU EMIR application process.

12.2 There is no, or no significant, impact on the public sector.

12.3 An Impact Assessment will be published alongside the Explanatory Memorandum on the legislation.gov.uk website, when an opinion from the Regulatory Policy Committee has been received.

12.4 The Treasury's decision to publish the regulations without a final Impact Assessment aims to ensure that industry and regulators have as much time as possible to familiarise themselves with the regulatory changes.

13. Regulating small business

13.1 The legislation does not apply to activities that are undertaken by small businesses.

14. Monitoring & review

14.1 As this instrument is made under the EU Withdrawal Act 2018, no review clause is required.

15. Contact

15.1 Verena Carmichael at the Treasury. Telephone: 0207 270 4794 or email: verena.carmichael@hmtreasury.gov.uk can be contacted with any queries regarding the instrument.

15.2 Clare Bolingford at the Treasury can confirm that this Explanatory Memorandum meets the required standard.

15.3 The Economic Secretary to the Treasury (John Glen) can confirm that this Explanatory Memorandum meets the required standard.

Annex

Statements under the European Union (Withdrawal) Act 2018

Part 1

Table of Statements under the 2018 Act

This table sets out the statements that may be required under the 2018 Act.

Statement	Where the requirement sits	To whom it applies	What it requires
Sifting	Paragraphs 3(3), 3(7) and 17(3) and 17(7) of Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) to make a Negative SI	Explain why the instrument should be subject to the negative procedure and, if applicable, why they disagree with the recommendation(s) of the SLSC/ESIC
Appropriate-ness	Sub-paragraph (2) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2	A statement that the SI does no more than is appropriate.
Good Reasons	Sub-paragraph (3) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2	Explain the good reasons for making the instrument and that what is being done is a reasonable course of action.
Equalities	Sub-paragraphs (4) and (5) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2	Explain what, if any, amendment, repeals or revocations are being made to the Equalities Acts 2006 and 2010 and legislation made under them. State that the Minister has had due regard to the need to eliminate discrimination and other conduct prohibited under the Equality Act 2010.
Explanations	Sub-paragraph (6) of paragraph 28, Schedule 77	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2 In addition to the statutory obligation the Government has made a political commitment to include these statements alongside all EUWA SIs	Explain the instrument, identify the relevant law before exit day, explain the instrument's effect on retained EU law and give information about the purpose of the instrument, e.g., whether minor or technical changes only are intended to the EU retained law.
Criminal	Sub-paragraphs (3) and (7)	Ministers of the Crown	Set out the 'good reasons' for creating a

offences	of paragraph 28, Schedule 7	exercising sections 8(1), 9, and 23(1) or jointly exercising powers in Schedule 2 to create a criminal offence	criminal offence, and the penalty attached.
Sub-delegation	Paragraph 30, Schedule 7	Ministers of the Crown exercising sections 10(1), 12 and part 1 of Schedule 4 to create a legislative power exercisable not by a Minister of the Crown or a Devolved Authority by Statutory Instrument.	State why it is appropriate to create such a sub-delegated power.
Urgency	Paragraph 34, Schedule 7	Ministers of the Crown using the urgent procedure in paragraphs 4 or 14, Sch 7.	Statement of the reasons for the Minister's opinion that the SI is urgent.
Explanations where amending regulations under 2(2) ECA 1972	Paragraph 13, Schedule 8	Anybody making an SI after exit day under powers outside the European Union (Withdrawal) Act 2018 which modifies subordinate legislation made under s.2(2) ECA	Statement explaining the good reasons for modifying the instrument made under s.2(2) ECA, identifying the relevant law before exit day, and explaining the instrument's effect on retained EU law.
Scrutiny statement where amending regulations under 2(2) ECA 1972	Paragraph 16, Schedule 8	Anybody making an SI after exit day under powers outside the European Union (Withdrawal) Act 2018 which modifies subordinate legislation made under s.2(2) ECA	Statement setting out: a) the steps which the relevant authority has taken to make the draft instrument published in accordance with paragraph 16(2), Schedule 8 available to each House of Parliament, b) containing information about the relevant authority's response to— (i) any recommendations made by a committee of either House of Parliament about the published draft instrument, and (ii) any other representations made to the relevant authority about the published draft instrument, and, c) containing any other information that the relevant authority considers appropriate in relation to the scrutiny of the instrument or draft instrument which is to be laid.

Part 2

Statements required when using enabling powers under the European Union (Withdrawal) 2018 Act

1. Appropriateness statement

1.1 The Economic Secretary to the Treasury (John Glen) has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

1.2 "In my view, the Central Counterparties (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018 does no more than is appropriate. This is the case because this instrument only does what is necessary to ensure a seamless continuation of services by non-UK CCPs can be provided in the UK. As set out in section 2, to ensure the retained EMIR operates effectively after the UK withdraws from the EU, various provisions must be in place. These include: transferring the equivalence and recognition functions to relevant UK authorities; and ensuring that all non-UK CCPs, including CCPs established in the EU, are considered as third country CCPs for the purpose of the UK's post exit-day third country regime for CCPs".

2. Good reasons

2.1 The Economic Secretary to the Treasury (John Glen) has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

2.2 "In my view, there are good reasons for the provisions in this instrument, and I have concluded they are a reasonable course of action. The policy rationale for the provisions contained within this instrument is set out in section 7 of the memorandum. The aim of the provisions is to ensure that a workable process for recognising non-UK CCPs for the UK market is in place before exit day to enable a smooth transition over exit day and avoid disruption to financial markets".

3. Equalities

3.1 The Economic Secretary to the Treasury (John Glen) has made the following statement(s) "The instrument does not amend, repeal or revoke a provision or provisions in the Equality Act 2006 or the Equality Act 2010 or subordinate legislation made under those Acts".

3.2 The Economic Secretary to the Treasury (John Glen) has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

3.3 "In relation to the instrument, I, Economic Secretary to the Treasury (John Glen) have had due regard to the need to eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Equality Act 2010."

4. Explanations

4.1 The explanations statement has been made in section 2 of the main body of this explanatory memorandum.

5. Criminal offences

5.1 The Economic Secretary to the Treasury (John Glen) has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

5.2 "In my view, there are good reasons for the creation of a criminal offence and for the penalty in respect of it in the Central Counterparties (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018."

5.3 Regulation 23 of this instrument extends the criminal offence of misleading the BoE to non-UK CCPs in relation to any information given to the BoE in purported compliance with the provisions in Part 6 of this instrument. This offence currently applies to all UK CCPs authorised by the BoE and the amendment maintains consistency in relation to all CCPs that the BoE authorises or recognises

6. Legislative sub-delegation

6.1 The Economic Secretary to the Treasury (John Glen) has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

6.2 "In my view, it is appropriate to create a relevant sub-delegated power in the Central Counterparties (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018. It is appropriate to delegate the power to make regulatory technical standards under Article 25.8 to the BoE because it will give the BoE the necessary powers to ensure that EU-derived technical regulations for which they are responsible will operate effectively after exit, subject to mechanisms to ensure robust HM Treasury oversight. This is in line with the approach that the government has set out in which legislative responsibility for Level 2 technical legislation in financial services will be transferred to the financial regulators, while the Treasury will have responsibility for changes to Level 1 legislation which Parliament will approve."