EXPLANATORY MEMORANDUM TO

THE UNCERTIFICATED SECURITIES (AMENDMENT AND EU EXIT) REGULATIONS 2019

2019 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Act.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This instrument amends the Uncertificated Securities Regulations (S.I. 2001/3755) ("the USR"). The instrument is necessary in light of the effect of Regulation (EU) 909/2014 ("the CSDR") as implemented in the UK via the Central Securities Depositories Regulations 2014 (S.I. 2014/2879) ("the 2014 Regulations") and the Central Securities Depositories Regulations 2017 (S.I. 2017/1064) ("the 2017 Regulations"). This legal framework is referred to below as "the CSDR regime". The instrument amends or revokes certain provisions which overlap with requirements now the subject of the CSDR regime. The instrument also reflects the fact that operators of relevant systems (broadly systems that transfer securities electronically) are currently approved under the USR. Under the CSDR regime, such operators will be authorised or recognised as Central Securities Depositories ("CSDs"), EEA CSDs, or third country CSDs.

2.2 The instrument expands the concept of "operator" for the purposes of the USR, ensuring the term covers recognised CSDs that are established in the UK, or CSDs that are established in the European Economic Area ("EEA") or third countries, and authorised or recognised by the authorities of an EEA State or the European Securities and Markets Authority ("ESMA") respectively.

2.3 The instrument makes consequential amendments to primary legislation, namely the Companies Act 2006 (c.46) and the Financial Services (Banking Reform) Act 2013 (c.33). The instrument also makes consequential amendments to a number of pieces of secondary legislation. These amendments are predominantly to reflect the fact that, with the introduction of the CSDR regime, operators of relevant systems will obtain this status by virtue of obtaining authorisation or recognition as a CSD, rather than the previous route of applying under the USR.

2.4 The instrument also addresses failures of retained EU law arising from the withdrawal of the United Kingdom from the European Union. To ensure the UK retains an operative regulatory framework for uncertificated securities post exit, amendments are made in exercise of the powers in section 8(1) of and schedule 4 to, the European Union (Withdrawal) Act 2018 ("EUWA") (c.16) and come into force on exit day in the event of a no deal scenario.

Explanations

What did any relevant EU law do before exit day?

2.5 The USR enable title to units of a security to be evidenced and transferred electronically by means of "relevant systems", rather than by a written instrument. The USR also set out the legal framework which the operator of a relevant system must adhere to. Within the USR, "relevant system" means a computer-based system, and procedures, which enable title to units of a security to be evidenced and transferred electronically.

Why is it being changed?

2.6 Certain provisions within the USR overlap with requirements which are now the subject of the CSDR regime and therefore need to be revoked to ensure successful operation of the CSDR regime and avoid duplication and uncertainty as to the rules governing the operation of relevant systems. These amendments will come into force regardless of the outcome of exit negotiations.

2.7 The instrument also addresses deficiencies in UK law and retained EU law that arise from the UK leaving the EU. It forms part of the Treasury's contingency planning for a no deal scenario, making the necessary changes to ensure the UK continues to have a functioning financial services regime from exit day, in that event.

What will it now do?

2.8 The instrument amends the definition of operator to reflect the introduction of the CSDR regime and the fact that authorised or recognised CSD status for CSDR purposes will be the future route to operator status, rather than applications under the USR. Accordingly, the provisions concerning applications for approval under the USR have been substantially modified.

2.9 The instrument also provides transitional provisions, to ensure that operators of systems that were approved as operators under the USR prior to 30 March 2017 can continue to operate under the current version of the USR, pending their authorisation as a CSD under the CSDR regime.

2.10 The instrument also makes amendments to ensure the USR operate effectively after the UK withdraws from the EU. These amendments address failures of retained EU law to operate effectively following exit. More detail on the specific changes being made in these areas can be found in Section 7 of this memorandum.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 The instrument depends on the laying of another instrument being made under Section 8 EUWA. Regulation 16 inserts a new regulation 5O into the 2014 Regulations to ensure that the Bank can charge fees in connection with its new functions in relation to third country CSDs after exit. At regulation 1(2), the 2014 regulations define third country CSDs by cross referring to section 285 of the Financial Services and Markets Act 2000 ("FSMA"). Broadly, S.285(1)(g) FSMA currently defines third country CSDs as those established outside the EEA. S.285 FSMA will be amended with effect from exit day by regulation 5(2) of the proposed Investment Exchanges, Clearing Houses and Central Securities Depositories (Amendment) (EU Exit) Regulations

2019. Those regulations are due to be laid in draft under the affirmative resolution procedure. This amendment will ensure that for the purposes of s.285 FSMA and the definitions which rely on it, a third country CSD is one established outside the UK and recognised under Article 25 of the CSDR.

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.

3.3 It is an amending instrument which has the same territorial application as the legislation being amended, which extends to England and Wales, Scotland and Northern Ireland.

4. Extent and Territorial Application

4.1 The extent of this instrument is the United Kingdom.

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

5. European Convention on Human Rights

5.1 The Economic Secretary to the Treasury has made the following statement regarding Human Rights:

"In my view the provisions of the Uncertificated Securities (Amendment and EU Exit) Regulations 2018 are compatible with the Convention rights."

6. Legislative Context

6.1 The USR created a regulatory framework in the UK for approving and supervising an operator of a relevant system. A "relevant system" in the context of the USR refers to a computer-based system that electronically registers and transfers securities. The USR came into force on the 26 November 2001.

6.2 Certain provisions within the USR are now the subject of the CSDR, which creates a common authorisation, supervision and regulatory framework for CSDs across the EU. The CSDR harmonises the timing and conduct of securities settlement in the EU and the rules governing CSDs which operate the infrastructures enabling settlement. Those provisions in the USR that overlap with the CSDR regime have, therefore, been removed.

6.3 The CSDR was implemented in the UK in stages via two sets of regulations. The 2014 Regulations, which came into force on 21 November 2014, and the 2017 Regulations, which came into force on 28 November 2017.

6.4 In accordance with the CSDR implementation and EU transitional provisions, most provisions of the CSDR only have effect once CSDs are authorised under the CSDR. The EU delegated legislation allowing that authorisation process to start came into force on 30 March 2017.

6.5 Article 49 of CSDR creates a directly applicable right for issuers to issue securities into a CSD in another member state, with the corporate law of the issuer continuing to apply to the securities in question. Accordingly, it has been necessary to ensure that there are no provisions in the USR which are incompatible with this right. By removing the duplication between CSDR and USR requirements for operators of relevant systems, the instrument provides clarity in this area.

7. Policy background

What is being done and why?

7.1 The CSDR is a directly applicable EU regulation governing the operation of CSDs. It was adopted by the European Parliament on 15 August 2014 and published in the Official Journal of the European Union (OJEU) on 28 August 2014. The UK was supportive of the overall objectives of the CSDR, which provides a harmonised regulatory and prudential regime for CSDs, harmonises and increases the robustness and resilience of securities settlement arrangements and creates a single market for CSD services across the EU.

7.2 As an EU regulation, the CSDR is directly applicable in all Member States. However, some adjustments have been made to the domestic legislative framework to ensure it is compatible with the CSDR. The 2014 Regulations and 2017 Regulations made competent authority designations; granted enforcement powers to UK regulators; and disapplied domestic law conflicting or overlapping with the CSDR.

7.3 The Treasury has identified that it is necessary to lay a final statutory instrument to ensure the domestic framework is compatible with the CSDR before the one CSD established in the UK is authorised.

7.4 This instrument makes amendments to the USR, including the following:

- Amending the definition of Operator to refer to CSDs, EEA CSDs and third country CSDs.
- Replacing the USR provision that currently deals with applications for operator status.
- Amending Schedule 1 of the USR, which sets out detailed requirements for the approval of a legal person as an Operator of a securities settlement system. These requirements overlap with the conditions for authorisation set out in the CSDR regime and relevant binding technical standards.
- Creating transitional provisions, to ensure that operators of systems that were approved as operators under the USR prior to 30 March 2017 can continue to operate under the current version of the USR, pending their authorisation as a CSD under the CSDR regime.
- Making consequential amendments to primary and secondary legislation other than the USR. For instance, references to Operators in other legislation are amended to match the new regime.
- Correcting deficiencies in retained EU law under section 8 of the EUWA to ensure the USR operate correctly after exit.
- Amending Article 15 of Regulation (EU) 236/2012 (the EU regulation on Short Selling) to ensure it operates correctly after exit.
- Inserting into the 2014 Regulations a power for the Bank of England to charge fees to third country CSDs. This is necessary in connection with the Bank of England's role after exit under the CSDR regime, which will include recognising and supervising CSDs in third countries. That new role was granted in the instrument amending the CSDR Regime on exit (the Central Securities Depositories (Amendment) (EU Exit) Regulations 2018). This provision relies on an amendment to the definition of "third country CSD" in section 285 FSMA that is to be introduced in the proposed Investment

Exchanges, Clearing Houses and Central Securities Depositories (Amendment) (EU Exit) Regulations 2019.

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 EUWA 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 the power in paragraph 1 of Schedule 4 to the EUWA, which concerns provisions relating to fees. In accordance with the requirements of the EUWA the Minister has made the relevant statements as detailed in Part 2 of the Annex to this Explanatory Memorandum.

8.2 Alongside the EUWA powers the instrument is also being made under section 2(2) of the European Communities Act 1972 (c.68) and provisions of the Companies Act 2006 relating to the USR. This is because the majority of the provisions in the instrument relate to the correct functioning of the CSDR regime and do not depend on the UK leaving the EU to come into effect.

9. Consolidation

9.1 There are no plans to consolidate the legislation amended by this instrument.

10. Consultation outcome

10.1 The Treasury ran a public consultation on the implementation of the CSDR which opened on 8 December 2015 and closed on 4 February 2016. The consultation focussed on competent authority designations; settlement internalisers; recognition and authorisation of CSDs; enforcement powers; the right to issue securities in an authorised CSD and transitional provisions.

10.2 The consultation document sought views concerning two draft statutory instruments: the Central Securities Depositories Regulations (which were in due course made as the 2017 Regulations) and the Uncertificated Securities (Amendment) Regulations (the precursor to this instrument). The government decided to publish a separate response document for questions relating to each statutory instrument. A response document focussing on the draft 2017 Regulations was published on 11 September 2017. The 2017 Regulations made additional competent authority designations, removed overlapping legislation, provided the Bank and the FCA with additional enforcement powers and made consequential amendments. All documents relating to this consultation can be found on the gov.uk website[1]. This includes the response document related to this instrument, which is due to be published shortly.

10.3 The Treasury received three responses to the consultation document. It has considered each response carefully and amended the draft instrument accordingly.

10.4 Respondents broadly agreed with the Treasury's proposed positions on most issues.

10.5 The Treasury asked respondents whether they agreed with the proposed approach to implementing Article 49(1) CSDR. Article 49(1) provides an issuer the right to issue securities into any CSD set up within the EU. One respondent did not agree with the

[1] www.gov.uk/government/consultations/consultation-on-the-implementation-of-the-central-securities-depositories-regulation-csdr

Treasury's approach and suggested a model whereby a 'single law CSD', outside the USR framework, would be entered on the register of the underlying issuer for the relevant securities. The Treasury considered that the model did not strictly fulfil the requirements of Article 49(1). The Treasury also took into account the existing market solution enabling the transfer in the UK of interests representing foreign securities, and the lack of anticipated demand for cross-border issuance as envisaged by Article 49(1), due to factors such as the need for tax and corporate law harmonisation. Further, the Treasury considers that the USR does not contain any material obstacle to an issuer exercising its right under Article 49(1) by issuing securities into a UK CSD. Accordingly, the Treasury is taking a proportionate approach to implementing Article 49(1), which involves fewer changes than those contained in the draft Uncertificated Securities (Amendment) Regulations consulted on in 2015.

10.6 In the consultation document, the government also asked whether respondents agreed with the approach to include third country CSDs within the definition of "Operator", and, in particular, to treat third country CSDs in the same way as EEA CSDs. One respondent felt that the Bank should be granted information-gathering and enforcement powers in relation to third country CSDs recognised by ESMA. However, Article 25 of the CSDR is framed with reference to the host competent authority being permitted to request information from the home competent authority and not through direct dealing with the third country CSD. The government considers that since ESMA is required to put in place cooperation agreements between competent authorities, and the powers of Member States in Article 25 of CSDR must be exercised in close cooperation with ESMA, it is not appropriate to provide the Bank of England specific information-gathering or enforcement powers in respect of third country CSDs before exit. We have therefore maintained our proposed approach.

10.7 The final question in the consultation document asked whether the proposed omissions in Schedule 1 were appropriate, and whether there were other provisions in Schedule 1 that should be omitted due to inconsistencies or overlapping with CSDR requirements. One respondent noted that the paragraph relating to circumstances where the Operator of a relevant system causes or permits part of the relevant system which is not the Operator system to be operated by another person, should be retained as these arrangements will not be outsourcing arrangements by the Operator and that such specific arrangements relating to relevant systems are within the scope of the CSDR. The government decided to retain paragraph 4 as it considers such a situation not to be strictly outsourcing within the terms of Article 30 and therefore not directly overlapping with CSDR.

10.8 Two respondents commented that paragraphs 7 and 8 of Schedule 1 should be retained, as they provide for checks on whether the transferor has sufficient units to transfer. The government came to the view that these paragraphs provide specific provisions in relation to reconciliation of units within an individual transfer instruction, whereas CSDR deals with reconciliation more generally across each securities issue. The Treasury has decided to retain these paragraphs.

11. Guidance

11.1 It is not considered necessary to issue specific guidance in connection with these Regulations.

12. Impact

12.1 The impact on business, charities or voluntary bodies will be limited to the costs of familiarisation with the rules governing uncertificated securities and CSDs, which will require legal examination of the amendments to the USR and CSDR. We anticipate this would be achieved through in-house lawyers or external counsel.

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

12.3 An Impact Assessment has not been prepared as the costs on business associated with this instrument will be negligible. A de minimis form is submitted with this memorandum and will be published alongside the Explanatory Memorandum on the legislation.gov.uk website.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 We do not consider that small businesses will be disproportionately affected. The Treasury has, therefore, taken the decision not to assist small business.

14. Monitoring & review

14.1 A statutory review clause is included in the instrument, which specifies that the Treasury must carry out a review of the regulatory provision contained in the instrument and publish a report setting out the conclusions of the review. The first report must be published on or before the expiration of a period of five years beginning with the date on which the instrument comes into force. For those amendments made under the EUWA, no review clause is required.

15. Contact

15.1 John Hughes at the HM Treasury Telephone: 020 7270 4481 or email: John.Hughes@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.

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

15.3 John Glen at HM Treasury 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 clauses 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 clauses 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 clauses 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 clauses 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 7	Ministers of the Crown exercising clauses 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 clauses 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 clauses 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 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 EUWA:

"In my view the Uncertificated Securities Regulations (Amendment) (EU Exit) Regulations 2019 does no more than is appropriate."

1.2 This is the case because this instrument only does what is necessary to ensure the UK retains an operative regulatory framework for the USR post exit. As set out in Section 2, these amendments include: amendments to reflect that approved operators under the USR are now authorised or recognised under the CSDR and Part 18 of the Financial Services and Markets Act 2000; expands the concept of "operator" for the purposes of the USR; removes the requirements for approval of an operator from the USR, which are now provided for under the CSDR; and addresses failures of retained EU law to operate effectively following exit".

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 EUWA:

"In my view, there are good reasons for the provisions in this instrument, and I have concluded they are a reasonable course of action."

2.2 The policy rationale for the provisions contained within this instrument is set out in sections 2 and 7 of the memorandum. The SI addresses deficiencies in UK law and retained EU law that arise from the UK leaving the EU. It forms part of HM Treasury's contingency planning for a no deal scenario, making the necessary changes to ensure the UK continues to have a functioning financial services regime from exit day, regardless of the outcome of negotiations. These provisions ensure a smooth transition after exit day and avoid increased legal uncertainty, costs and inefficiency by minimising disruption to financial markets".

3. Equalities

3.1 The Economic Secretary to the Treasury, John Glen, has made the following statement(s)

"The statutory 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 EUWA:

"In relation to the statutory instrument, I, the 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 paragraph 2 of the main body of this explanatory memorandum.