

EXPLANATORY MEMORANDUM TO
THE OVER THE COUNTER DERIVATIVES, CENTRAL COUNTERPARTIES AND
TRADE REPOSITORIES (AMENDMENT, ETC., AND TRANSITIONAL
PROVISION) (EU EXIT) REGULATIONS 2020

2020 No. 646

1. Introduction

- 1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.
- 1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

- 2.1 This instrument is being made in order to ensure a coherent and functioning financial services regulatory regime in the United Kingdom (UK) at the end of the Transition Period. Specifically, this instrument is being made to address deficiencies in retained EU law in the European Market Infrastructure Regulation (EU) No. 648/2012 (known as “EMIR”), as amended by Regulation (EU) No. 2019/2099 (known as “EMIR 2.2” or “EMIR supervision”).
- 2.2 EMIR sets out a framework to regulate over-the-counter (OTC) derivatives, central counterparties (CCPs) and trade repositories (TRs). EMIR 2.2, which entered into application on 1 January 2020, amends EMIR to introduce an updated third country (i.e. non-EU) CCP supervision framework. This instrument ensures that EMIR and related legislation will continue to operate effectively at the end of the Transition Period following this update.

Explanations

What did any relevant EU law do before exit day?

- 2.3 In 2009 the G20 made a commitment to ensure that derivative trades would be cleared in CCPs. EMIR implemented this commitment for the EU and mandates the use of CCPs for certain OTC derivative transactions (derivatives traded directly between two parties).
- 2.4 CCPs are used by firms to manage counterparty risk when trading derivative products. A derivative is a contract between two or more parties, whose value is based on an underlying asset or set of assets. CCPs stand between the buyer and seller of a derivative product in order to guarantee the performance of the contract. This means that the CCP will ensure the contract is honoured even if one of the parties goes into default.
- 2.5 In EMIR 2.2, the EU is aiming to ensure that EU authorities have tools to manage financial stability risks posed by some of the largest third country (i.e. non-EU) CCPs.
- 2.6 EMIR 2.2 enhances the recognition regime for third country CCPs by implementing a tiering system. It introduces a dedicated regime for the third country CCPs which are, or likely to become, systemically important for the financial stability of the EU or of one or more of its Member States. These are referred to as Tier 2 CCPs. Tier 2 CCPs

will need to comply with the requirements under EMIR in order to be recognised, and the European Securities and Markets Authority (ESMA) will have ongoing supervisory responsibility for Tier 2 CCPs.

- 2.7 EMIR 2.2 also makes changes to wider EU processes, including the introduction of a “CCP supervisory committee” inside ESMA and increased responsibility for EU supervisory colleges, alongside a fee system for third country CCPs to fund supervisory activities.

Why is it being changed?

- 2.8 In preparation for the UK’s withdrawal from the EU on 31 January 2020, Parliament approved several EU Exit instruments to ensure that EMIR would continue to operate effectively in the UK at the end of the Transition Period.
- 2.9 Section 3 of the EU (Withdrawal) Act 2018 (EUWA), as amended by the European Union (Withdrawal Agreement) Act 2020, operates to ensure that all directly applicable EU law will form part of UK law at the end of the Transition Period (“retained EU law”). Since EMIR 2.2 amends EMIR, this updated version of EMIR will form part of retained EU law in the UK. Deficiency fixes are therefore necessary to ensure that EMIR will continue to operate effectively in the UK at the end of the Transition Period.

What will it now do?

- 2.10 This instrument ensures that EMIR, as retained EU law, continues to function effectively in the UK.
- 2.11 Part 2 of this instrument makes changes to primary legislation - the Financial Services and Markets Act 2000 (FSMA). These changes expand the UK’s existing CCP supervisory framework to cover third county CCPs, in order to ensure that the Bank of England is able to undertake the necessary supervisory responsibilities required under the EMIR 2.2 framework. This is explained further in paragraph 2.19 below.
- 2.12 Part 3 of this instrument ensures that the references to the EMIR regulation in UK legislation are up to date. It also makes changes to a number of EU Exit instruments made under section 8 of the EUWA. These instruments addressed deficiencies in EMIR arising as a result of exit, and some updates are necessary to ensure the deficiency fixes now operate effectively with the changes introduced to EMIR by EMIR 2.2. Principally, Part 3 updates existing legislation in order to ensure the Bank of England can assess third country CCP applications in line with the new EMIR 2.2 provisions before the end of the Transition Period. This is explained further in paragraphs 2.26 and 2.27 below.
- 2.13 Part 4 of this instrument addresses deficiencies in EMIR, as amended by EMIR 2.2, to ensure that the UK continues to have an effective regulatory framework for OTC derivatives and CCPs after the end of the Transition Period. The principal deficiency fixes included are explained in sub-paragraphs 2.14 to 2.27 below.

Transfer of functions

- 2.14 In the UK, responsibility for recognising third country CCPs has already been transferred from ESMA to the Bank of England in the Central Counterparties (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018 (S.I. 2018/1184) (known as the “TRR SI”). As EMIR 2.2 introduces new elements to the

third country CCP recognition process, this instrument transfers new responsibilities in this process from ESMA to the Bank of England.

- 2.15 The functions of the European Commission are transferred to HM Treasury, apart from the power to make two delegated acts which sit more appropriately with the Bank of England. This is explained in paragraph 2.24 and 2.25 below.
- 2.16 EMIR 2.2 also makes changes to wider EU processes, including creating a CCP supervisory committee inside ESMA and increased responsibility for EU supervisory colleges. As the UK is no longer a part of the EU, these provisions are removed by this instrument, or the relevant articles have already been removed by earlier SIs addressing deficiencies in EMIR.

Tiering

- 2.17 EMIR 2.2 empowers ESMA to tier third country CCPs according to their systemic importance to the EU as part of the recognition process. Tier 1 CCPs will continue to be supervised by their home regulator alone. Systemic CCPs will be recognised as Tier 2 and subject to supervision by ESMA.
- 2.18 Regulation 20 of this instrument transfers the responsibility for tiering third country CCPs according to their systemic importance to the UK to the Bank of England as part of their existing responsibility for recognising third country CCPs.

Ongoing supervision

- 2.19 This instrument transfers ESMA's new supervisory responsibility over Tier 2 CCPs to the Bank of England. To facilitate this, regulations 2 and 11 extend the existing supervisory framework and tools which the Bank of England uses to supervise UK CCPs to also apply to third country CCPs. This includes providing the Bank of England with powers to investigate and take supervisory action against Tier 2 CCPs, mirroring the powers ESMA currently has. This will ensure the Bank of England is able to fulfil its new responsibilities. The Bank of England were given the ability to raise fees from third country CCPs in a previous SI addressing deficiencies in EMIR.
- 2.20 In addition, this instrument ensures the Bank of England has the discretion necessary to sign appropriate and workable Memorandums of Understanding with third country competent authorities of recognised CCPs, to ensure the Bank of England is able to fulfil its supervisory obligations.

Location Policy

- 2.21 Under EMIR 2.2, ESMA can recommend to the Commission that a third-country CCP which is 'substantially systemically important' cannot offer some services to EU clearing members unless those services are offered from inside the EU (referred to as the "location policy").
- 2.22 The UK did not support the inclusion of the location policy during the negotiation of the underlying regulation, noting concerns that it could lead to market fragmentation and reduce the benefits provided by the global nature of clearing. However, removing such a provision could be judged to be outside the commitments the Government gave to Parliament concerning the usage of EUWA powers not to make major policy changes.
- 2.23 As such, regulation 21 of this instrument transfers the power to use the location policy from the Commission to HM Treasury, following advice from the Bank of England,

and subject to appropriate procedural safeguards and transitional provisions. The power would be exercised via regulation subject to negative resolution, allowing for Parliamentary oversight. However, it is hard to foresee a circumstance in which using the location policy would be effective in supporting financial stability in the UK and therefore it is unlikely to be appropriate to ever use this tool in practice.

Delegated acts

- 2.24 EMIR 2.2 empowers the Commission to adopt several delegated acts to further specify how the framework will apply in practice, including more detail on tiering criteria and deference to the rules of home authorities (“comparable compliance”). These two delegated acts are important in establishing how the UK will assess and manage the systemic risk posed by some third country CCPs.
- 2.25 This instrument transfers the power to make the two delegated acts mentioned above to the Bank of England to be made via binding technical standards. This is consistent with the Bank of England’s existing responsibilities for safeguarding financial stability in general, and managing systemic risk in CCPs in particular. This will enable them to further specify tiering criteria and establish a supervisory cooperation framework which manages the systemic risk posed by some third county CCPs in a way which is appropriate for the UK.

Recognition powers during the Transition Period

- 2.26 The TRR SI established a ‘Temporary Recognition Regime’ (TRR) to enable third country CCPs to continue their activities in the UK after exit day for a period of three years while their recognition applications were assessed.¹ In addition, this SI empowered HM Treasury to make equivalence decisions, and the Bank of England to make recognition decisions, ahead of Exit day. The Financial Services (Consequential Amendments) Regulations 2020, laid by HM Treasury in January 2020, have shifted the application of this regime to trigger at the end of the Transition Period. Regulation 13 in this instrument updates these recognition powers to allow the Bank of England to assess those third country CCPs that have already applied for recognition under Regulation 12 of the TRR SI in line with the new EMIR 2.2 provisions, before the end of the Transition Period.
- 2.27 It is appropriate to assess these CCPs against the current regime in order to reflect the updated provisions under EMIR 2.2. This provides certainty for third country CCPs as regards their recognition for the UK market during the Transition Period.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 Regulation 30 of this instrument corrects a defect in the amendment of Article 81(3) EMIR made by the Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2019 (S.I. 2019/1416). In accordance with the requirement stated in paragraph 4.7.6 of the Statutory Instrument Practice, HM Treasury has consulted with the SI

¹ An interim list of the third country CCPs which have entered this regime is available here: <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability/financial-market-infrastructure-supervision/interim-list-of-third-country-ccp>

Registrar. As this correction represents only a small part of this instrument the procedure for free issue has not been applied.

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 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, John Glen, has made the following statement regarding Human Rights:

“In my view the provisions of The Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2020 are compatible with the Convention rights.”

6. Legislative Context

- 6.1 This instrument amends EMIR as it will be retained EU law by virtue of section 3 of the EUWA as amended by the European Union (Withdrawal Agreement) Act 2020. This is necessary as EMIR has been updated by EMIR 2.2, introducing a new set of provisions which must be amended to operate effectively in the UK.
- 6.2 There have been several other instruments made under section 8 of the EUWA which have made amendments to EMIR to ensure it works in a UK context after EU withdrawal. This instrument amends those instruments to ensure they continue to operate effectively after exit. This includes: Financial Regulators’ Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018; Central Counterparties (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018; Trade Repositories (Amendment and Transitional Provision) (EU Exit) Regulations 2018; Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2019; Equivalence Determinations for Financial Services and Miscellaneous Provisions (Amendment etc.) (EU Exit) Regulations 2019; Transparency of Securities Financing Transactions and of Reuse (Amendment) (EU Exit) Regulations 2019; Benchmarks (Amendment and Transitional Provision) (EU Exit) Regulations 2019; Securitisation (Amendment) (EU Exit) Regulations 2019; Investment Exchanges, Clearing Houses and Central Securities Depositories (Amendment) (EU Exit) Regulations 2019; International Accounting Standards and European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2019; Financial Services (Miscellaneous) (Amendment) (EU Exit) Regulations 2019; and Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment etc., and Transitional Provision) (EU Exit) (No.2) Regulations 2019.

7. Policy background

What is being done and why?

- 7.1 The UK has left the EU with a deal and has entered a Transition Period lasting until 31 December 2020. During this period, common rules will continue to apply, access to each other's markets will continue as previously, and businesses, including financial services firms, will be able to trade on the same terms as previously. UK firms need to continue to comply with EU legislation, including any new EU legislation that becomes applicable during the Transition Period.
- 7.2 Since July 2018, HM Treasury has put in place legislation, using powers under the EUWA, to ensure that the UK has an independent and coherent financial services regulatory regime at the end of the Transition Period.
- 7.3 As far as possible, HM Treasury's approach ensures that the same laws and rules that are currently in place in the UK would continue to apply at the end of the Transition Period, to provide continuity and certainty to firms and their customers.
- 7.4 During the Transition Period, HM Treasury will continue to use powers under the EUWA, as amended by the European Union (Withdrawal Agreement) Act 2020, to prepare for 1 January 2021. In particular, as new EU legislation becomes applicable during the Transition Period, HM Treasury will bring forward further statutory instruments to ensure that it continues to operate effectively in the UK at the end of the Transition Period.

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 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. 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 has not undertaken a formal consultation on this instrument, but has engaged extensively with the Bank of England during the drafting process. HM Treasury has engaged with relevant stakeholders on its approach to Financial Services legislation under the EUWA, including on this instrument, to familiarise them with the legislation ahead of laying. In addition, a draft version of this instrument was published on 24 February 2020 to further allow stakeholders to familiarise themselves with the legislation ahead of laying.

11. Guidance

- 11.1 HM Treasury does not propose to provide any guidance in relation to these Regulations. ESMA and the competent authorities within the UK (the Bank of

England and the Financial Conduct Authority) have the power to issue guidance in relation to EMIR.

12. Impact

- 12.1 There is no, or no significant, impact on business, charities or voluntary bodies. While a small number of CCPs will likely be recognised as Tier 2 CCPs, and therefore face additional supervisory oversight from the Bank of England, this instrument only applies to CCPs established in third countries. This instrument does not make any changes to the regulatory or supervisory framework for firms based in the UK.
- 12.2 There is no, or no significant, impact on the public sector. The Bank of England will take on responsibility for tiering and supervising third country CCPs and establishing cooperation arrangements with the relevant third country authorities. The Bank of England will also take on responsibility for additional Binding Technical Standards as a result of the updates to EMIR. The impact on the Bank of England will be marginal as these new functions are consistent with the regulatory responsibilities these regulators currently have in the UK. In addition, the Bank of England is already empowered to levy fees on third country CCPs to reflect any additional costs as supervisor.
- 12.3 An Impact Assessment has not been prepared for this instrument because, in line with Better Regulation guidance, HM Treasury considers that the net impact on businesses will be less than £5million a year as this instrument does not make any changes to the regulatory or supervisory framework for firms based in the UK. As such, a de-minimis impact assessment has been carried out.

13. Regulating small business

- 13.1 This legislation does not apply to activities that are undertaken by small businesses. This instrument places some new obligations on third country CCPs and the Bank of England.

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 Jenny Chaplin at HM Treasury Telephone: 02072705043 or Email: Jenny.Chaplin@HMTreasury.gov.uk can be contacted with any queries regarding the instrument.
- 15.2 Tom Duggan, Deputy Director for Securities, Markets and Banking, at the HM Treasury can confirm that this Explanatory Memorandum meets the required standard.
- 15.3 John Glen, Economic Secretary to the Treasury 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 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/Sifting Committees
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 7	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 offences	Sub-paragraphs (3) and (7) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9, and 23(1) or jointly exercising powers in Schedule 2 to create a criminal offence	Set out the 'good reasons' for creating a 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, Schedule 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 MP) has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:
 - 1.2 “In my view the Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2020 do no more than is appropriate”.
 - 1.3 This is the case because: it is in line with the European Union (Withdrawal) Act 2018 in serving to make those changes necessary to provide a functioning statute book in relation to the financial markets infrastructure’s regulatory framework relating to over-the-counter derivatives, central counterparties and trade repositories on the day we leave the EU. This instrument does only what is necessary to ensure that the relevant legislation relating to over-the-counter derivatives, central counterparties and trade repositories continues to operate effectively at the point at which the UK leaves the EU. This can only be achieved through making the amendments to EMIR and the associated legislation contained in this instrument and through making the transitional provisions contained in this instrument. The explanation of the provisions made in this instrument is set out in section 7 of the memorandum.

2. Good reasons

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

“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 These reasons are: if the government were not to proceed with this legislation, then significant aspects of the UK’s regulatory regime for over-the-counter derivatives, central counterparties and trade repositories would become legally inoperable. The UK would risk not meeting international commitments made as part of its membership of the G20. This could affect UK market confidence and create financial instability.

3. Equalities

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

“The Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2020 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 MP) has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

“In relation to the Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2020 instrument, I, Economic Secretary to the Treasury, John Glen MP, 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. Legislative sub-delegation

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

“In my view it is appropriate to create relevant sub-delegated powers in the Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment) (EU Exit) Regulations 2020”.

- 5.2 The instrument transfers powers to the Bank of England to make binding technical standards. This is appropriate because the Bank of England will have the necessary technical knowledge to make assessments of certain matters contained within EMIR and will 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 the Financial Regulators’ Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018 (S.I. 2018/1115), in which legislative responsibility for Level 2 technical legislation in financial services will be transferred to the financial regulators.