

EXPLANATORY MEMORANDUM TO
THE CENTRAL COUNTERPARTIES (EQUIVALENCE) (UNITED STATES OF
AMERICA) (COMMODITY FUTURES TRADING COMMISSION) REGULATIONS
2023

2023 No. 1323

1. Introduction

- 1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of His Majesty.

2. Purpose of the instrument

- 2.1 This instrument is being made in order to specify that the legal and supervisory arrangements for certain central counterparties (CCPs) authorised by the Commodity Futures Trading Commission (CFTC), an independent federal agency of the government of the United States of America, are equivalent to the UK's corresponding regime.
- 2.2 The determination of equivalence conferred by this instrument is a precondition of a CCP authorised by the CFTC being able to become recognised by the Bank of England (the Bank) on a non-time limited basis. Upon being recognised by the Bank, CCPs are able to provide their clearing services to UK market participants.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 None

4. Extent and Territorial Application

- 4.1 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is the United Kingdom.
- 4.2 The territorial application of this instrument (that is, where the instrument produces a practical effect) is the United Kingdom.

5. European Convention on Human Rights

- 5.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

6. Legislative Context

- 6.1 The UK's regulatory framework for CCPs is set out primarily in the European Market Infrastructure Regulation¹ (EMIR), as retained in UK law by virtue of the European Union (Withdrawal) Act 2018 and amended by regulations made under section 8 of that Act. This legislation, as amended and forming part of retained EU law, is referred to in this explanatory memorandum as UK EMIR.

¹ Regulation 648/2012/EU of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories

- 6.2 At the end of the Transition Period on 31 December 2020, over 200 EU equivalence decisions were retained in UK law. Equivalence decisions for CCPs, made by the EU under Article 25(6) of EMIR, were not among those decisions as they were revoked by regulation 9 of The Central Counterparties (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018 (SI 2018/1184) (TRR Regulations). HM Treasury elected instead to provide for the UK to remake these equivalence decisions having conducted its own assessment of CCP regulatory regimes in overseas jurisdictions. Article 25(6) of UK EMIR therefore provides that HM Treasury may make regulations for this purpose, and provides for it to specify that:
- the legal and supervisory arrangements of a third country ensure that CCPs authorised in that third country comply on an ongoing basis with legally binding requirements which are equivalent to the requirements laid down in Title IV of UK EMIR;
 - those CCPs are subject to effective supervision and enforcement in that third country on an ongoing basis; and
 - the legal framework of that third country provides for an effective equivalent system for the recognition of CCPs authorised under legal regimes of other countries.
- 6.3 Article 25(1) of UK EMIR provides that overseas CCPs may only provide clearing services to clearing members or trading venues established in the United Kingdom if the CCP is recognised by the Bank. Article 25(2) sets out the circumstances in which the Bank may recognise an overseas CCP. This includes the requirement that HM Treasury has made regulations under Article 25(6).
- 6.4 In order to enable CCPs that had already been recognised by the EU to continue operating in the UK while equivalence and recognition decisions were made, HM Treasury established a temporary recognition regime (TRR) in regulations 11 to 26 of the TRR Regulations, which allows CCPs that were entitled to operate in the UK at the end of the Transition Period to continue doing so. Under the TRR, CCPs are able to continue to provide clearing services in the UK, if they were able to provide those services in the EU under EMIR before the end of the Transition Period and met certain conditions to enter, and remain in, this regime. The TRR is currently due to expire on 31 December 2025, having been extended by 1 year in length in September 2023.

7. Policy background

What is being done and why?

- 7.1 UK EMIR sets out regulatory and supervisory requirements for CCPs, as well as for trade repositories and for derivatives cleared on a bilateral basis.
- 7.2 CCPs are used by firms to reduce certain risks that arise when trading on financial markets, such as derivatives and equities markets. Derivatives are contracts between two or more parties, the value of which are based on an underlying asset. CCPs sit between the buyers and sellers of financial instruments like derivatives, providing assurance that contractual obligations will be fulfilled. The process of transacting through a CCP is known as “clearing”. CCPs have played a vital role in making markets safer following the 2008 financial crisis, and they help substantially in managing potential systemic risk arising from financial transactions. For this reason, the UK requires certain classes of derivative contracts to be cleared.

- 7.3 Enabling UK firms to access clearing services from overseas CCPs provides these firms with greater commercial choice. Access to overseas CCPs' services allow UK firms to more easily and directly engage in overseas derivatives markets, including products and clearing services that may not be easily accessible from UK CCPs.
- 7.4 Currently, UK firms can access clearing services provided by CCPs authorised by the CFTC, under the TRR.
- 7.5 As such, the equivalence determination made in these regulations does not alter the scope, or types, of service that CFTC-authorised CCPs are able to provide in the UK. Rather, it is only part of the process of moving from a temporary regime (the TRR) to a non-time limited regime.
- 7.6 In order to grant an equivalence determination, HM Treasury must be satisfied that the regime under assessment meets equivalent outcomes to those of the UK's regulatory regime.
- 7.7 To determine this in respect of the CFTC, HM Treasury has undertaken an assessment of their regime, measuring whether it achieves equivalent outcomes against the criteria set out in Article 25(6) of UK EMIR. That is:
- The legal requirements CFTC-authorised CCPs must comply with on an ongoing basis are equivalent to those set out in Title IV² of UK EMIR.
 - The CFTC effectively supervises and enforces against the CCPs it authorises, on an ongoing basis.
 - The legal system of the United States of America provides for an effective equivalent system for the recognition of CCPs authorised under legal regimes in other countries.
- 7.8 As a guideline for its assessment, HM Treasury has used the Principles on Financial Market Infrastructures (PFMIs)³. Agreed by the Committee on Payments and Market Infrastructures, and the International Organization of Securities Commissions, the PFMIs are a set of guidelines for appropriate regulation of financial market infrastructures, including CCPs. The PFMIs are widely adopted internationally – in the UK the standards of the PFMIs for CCPs are implemented through Title IV of UK EMIR.
- 7.9 As part of its assessment, HM Treasury received advice from the Bank, providing its view on whether equivalence on an outcomes basis to the UK regime has been achieved by the CFTC regime
- 7.10 HM Treasury has determined through its assessment that, on an outcomes basis, the CFTC regime for the regulation of systemically important CCPs is equivalent to that of the UK, because it meets the standards set out in the PFMIs. A list of clearing organisations registered with the CFTC can be found online⁴ The equivalence decision will only apply to CCPs that are registered with the CFTC, and have either:
- been classified as a Systemically Important Derivatives Clearing Organisation (SIDCO) due to designation by the U.S. Financial Stability Oversight Council;
- or

² Title IV of UK EMIR is the collective name for Articles 26-50 of UK EMIR. These articles set the requirements with which UK CCPs must comply.

³ [Principles for Financial Market Infrastructures \(bis.org\)](https://bis.org/principles/)

⁴ [Industry Filings: Derivatives Clearing Organizations \(DCO\) | CFTC](#)

- elected to become a ‘Subpart C’ Derivatives Clearing Organisation. This is a status where a CCP has volunteered to comply with the same requirements, contained in subpart C, Part 39⁵ of the CFTC’s regulations, as Systemically Important Derivatives Clearing Organisations.
- 7.11 Several of the principles in the PFMI emphasise that particularly systemically important CCPs should take extra steps to minimise risk. The CFTC regime has implemented some of these standards differently from Title IV of UK EMIR.
- 7.12 In HM Treasury’s view, two CCPs, the Chicago Mercantile Exchange Inc. (CME), and ICE Clear Credit LLC (ICE) are the only CCPs considered under this assessment whose failure could have a significant impact on UK financial stability. The CFTC is the primary regulator of both. HM Treasury has arrived at this judgement on the basis that CME and ICE:
- hold a significant amount of initial margin from UK clearing members. Initial margin is collateral posted by clearing members of a CCP to guard against future exposures the CCP may have if any participants in a transaction default before the transaction is fulfilled. Initial margin is calculated on the basis of the risk a particular contract would pose to the CCP, should one of the participants in the contract default; and
 - hold a significant amount of default fund contributions from UK clearing members. The default fund is a pool of financial contributions from a CCP’s clearing members that can be used to cover losses that may arise if any participants in a transaction default. In the UK, the extent of a particular clearing member’s contribution to the default fund is calculated proportional to a clearing member’s exposures to the CCP, based on criteria set by the CCP itself, so this can vary between CCPs.
- 7.13 Additionally, both ICE and CME have been declared as Systemically Important Derivatives Clearing Organisations by the U.S. Treasury Department’s Financial Stability Oversight Council. This fact has also been considered in HM Treasury’s assessment and decision as a key determinant of why these CCPs failure could significantly affect the stability of UK financial markets.
- 7.14 The CFTC regime has implemented certain standards in the PFMI relating to systemically important CCPs differently to UK EMIR in three separate areas:
- (a) Anti-procyclicality: procyclicality is the term used to describe the concept that a CCP’s margin requirements tend to increase in periods of market volatility – this has the potential to exacerbate existing stress in markets if firms are required to post increasing amounts of margin in order to cover their obligations to a CCP. The PFMI notes CCPs should address and limit procyclical margin changes, and UK EMIR requires CCPs to meet one of three specific requirements in order to meet this standard in the PFMI. The CFTC regime does not contain requirements of the same specificity as UK EMIR in relation to anti-procyclicality.
 - (b) Minimum liquidation period: the liquidation period is the length of time a CCP will take to resolve the default of a clearing member on a position (i.e. a particular contract). Minimum liquidation periods are in place in order to

⁵ The relevant aspect of CFTC regulation can be found here: [eCFR :: 17 CFR Part 39 Subpart C -- Provisions Applicable to Systemically Important Derivatives Clearing Organizations and Derivatives Clearing Organizations That Elect To Be Subject to the Provisions of This Subpart](#).

ensure that the CCP is able to resolve a position of a defaulting clearing member, and hold enough margin to cover any exposures relating to that position over that set period of time. The PFMI provide that CCPs should be subject to minimum liquidation periods, but do not specify the duration of this, nor if durations should be longer depending on the type of contract. Broadly, UK EMIR requires two-day liquidation periods for non-Over the Counter (OTC – a derivative transaction that is not executed on a UK, or UK equivalent, trading venue) derivative positions. For non-OTC transactions that meet certain conditions, this can be one day. UK EMIR requires a five-day liquidation period for OTC transactions. The CFTC regime permits a one-day liquidation period for a wider range of non-OTC transactions than allowed under UK EMIR.

- (c) Prefunded financial resources: the PFMI provide that CCPs which are systemically important in multiple jurisdictions should hold financial resources sufficient to cover the default of its two largest clearing members in extreme but plausible market conditions (this is known as a ‘cover 2’ requirement). The requirements for UK CCPs in UK EMIR that meet this standard are described in 7.16.3. The CFTC regime includes guidelines similar to the rules in UK EMIR in this area, however these are not legally binding requirements in and of themselves. Legally binding requirements on prefunded financial resources for CFTC-authorised CCPs only require coverage for the default of the single largest counterparty. Systemically important CCPs authorised by the CFTC only need to consider holding prefunded financial resources that provide coverage for the default of its two largest clearing members, but it is not a legal requirement for them to do so. Requirements on prefunded financial resources to cover the default of a CCP’s two largest clearing members in practice therefore only bind CFTC-authorised CCPs if they are adopted as part of the internal rules and procedures of those CCPs. HM Treasury understands that CME and ICE have implemented cover 2 requirements as part of their internal rules and procedures, and therefore do comply with the standard in the PFMI.

7.15 Although the CFTC’s legal regime does not impose binding requirements comparable to those in UK EMIR in relation to these three areas, CFTC-authorised CCPs designated by the U.S. Treasury Department’s Financial Stability Oversight Council as being systemically important, or which otherwise opt-in to that regime, are required to adopt internal rules and procedures which, once adopted, are legally binding upon that CCP. In practice, systemically important CFTC-authorised CCPs such as CME and ICE have adopted internal rules and procedures that are equivalent to the relevant rules of UK EMIR in the three areas set out above, and HM Treasury has therefore taken this into account in conducting its equivalence assessment, as it forms part of the legal and supervisory arrangements of the CFTC regime.

7.16 For the determination of equivalence therefore, HM Treasury will require specified CFTC-authorised CCPs to adopt internal rules and procedures equivalent to those in the three areas set out above, in order for these CCPs to be recognised by the Bank. These requirements will apply to all derivative contracts, with certain exemptions, cleared through CFTC-authorised CCPs whose failure could significantly affect the stability of UK financial markets:

- These CCPs must adopt one of the three measures set out in UK EMIR to address and limit procyclical changes in margin for all derivative contracts.

- These CCPs must adopt a two-day liquidation period for non-OTC derivative positions, where the margin for these positions is collected on a net basis.
 - These CCPs must hold a level of prefunded financial resources sufficient to cover the default of the two clearing members to which it has the largest exposures, under extreme but plausible market conditions.
- 7.17 Certain agricultural commodity derivative contracts, which meet all the conditions set out in regulation 4 of the instrument, being cleared through the specified CFTC- authorised CCPs will not be subject to the requirements outlined in 7.16.1-7.16.3. This, as with the rest of this instrument, is a continuation of the existing policy effect established under the TRR. HM Treasury has conducted an assessment of the participation of UK counterparties in derivative contracts that would be covered by this exemption and concluded that maintaining this exemption does not create material risks to UK financial stability. This is because these kinds of derivative contracts are mostly used by firms based in the USA to manage their commercial risk. As such, HM Treasury considers they have low interconnection with the UK's financial system, and imposing the conditions noted above would create disproportionate additional costs for these transactions.
- 7.18 These requirements will only be applicable to CCPs whose failure could have a significant impact on UK financial stability. This is because, for such CCPs, their adoption of appropriate internal rules and procedures as a prerequisite of being recognised by the Bank ensures the CFTC regime achieves equivalent outcomes to the UK's regime in respect of those CCPs. As it stands, this is only the case for two CCPs – CME and ICE. In future, however, if HM Treasury determine that other CFTC authorised CCPs have become CCPs whose failure could have a significant impact on UK financial stability, they will be added to the list of specified CCPs in the decision. Thereafter, they will be required to meet these requirements in order to become recognised, and to continue to be recognised by, the Bank.
- 7.19 As noted in paragraph 6.3, the Bank will conduct, separately and subsequent to the equivalence process, its own firm-level recognition assessment. This will include a decision on whether an overseas CCP that has applied for recognition should be classed as systemically important or likely to become systemically important for the financial stability of the United Kingdom (a Tier 2 CCP), or not (a Tier 1 CCP). In June 2022, the Bank published a policy document⁶ outlining its approach to 'tiering' incoming overseas CCPs. Tiering is a key aspect of the Bank's recognition process and determines the Bank's regulatory approach to that CCP. The Bank's tiering decision is separate from the decision of HM Treasury to apply requirements to CME and ICE.
- 7.20 It is during the recognition process that the Bank will check the compliance of CFTC- authorised CCPs whose failure could have a significant impact on the stability of UK financial markets with the requirements of the equivalence determination made by this instrument.
- 7.21 Once the instrument is in force, the Bank will then be able to begin processing applications for recognition from CCPs authorised by the CFTC.

⁶ [The Bank of England's approach to tiering incoming central counterparties under EMIR Article 25 - Statement of Policy](#)

8. European Union Withdrawal and Future Relationship

- 8.1 This instrument does not trigger the statement requirements under the European Union (Withdrawal) Act.

9. Consolidation

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

10. Consultation outcome

- 10.1 HM Treasury has not undertaken a public consultation on this instrument.
- 10.2 HM Treasury has engaged with and received advice from the Bank of England in relation to the equivalence determination contained in this instrument.

11. Guidance

- 11.1 No additional guidance will accompany this instrument.

12. Impact

- 12.1 There is no, or no significant, impact on business, charities or voluntary bodies.
- 12.2 There is no, or no significant, impact on the public sector.
- 12.3 A full Impact Assessment has not been prepared for this instrument because in line with Better Regulation guidance, HM Treasury considers that the net impact of this instrument will result in an Equivalent Annual Net Direct Cost to businesses of less than £5 million a year. Due to this limited impact, a de minimis impact assessment has been carried out. A copy of this assessment is published alongside this Explanatory Memorandum on the [legislation.gov.uk](https://www.legislation.gov.uk) website.

13. Regulating small business

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

14. Monitoring & review

- 14.1 The approach to monitoring of this legislation is as set out in the Memorandum of Understanding between HM Treasury, the Bank, the Prudential Regulation Authority and the Financial Conduct Authority, HM Treasury may review the equivalence determination periodically or at any time, or in response to changes to the applicable framework.⁷ This does not prejudice HM Treasury's ability to revoke the equivalence determination at any time.
- 14.2 Each regulator may also recommend to HM Treasury that a review of the equivalence determination is undertaken in response to material changes in the applicable framework. Furthermore, each regulator may request a review of the equivalence determination if they have concerns arising from their statutory objectives.
- 14.3 The instrument does not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015, the Economic Secretary to the Treasury, Bim Afolami MP, has made the following statement:

⁷ <https://www.gov.uk/government/publications/memorandum-of-understanding-equivalence-and-exemptions>

“It is not proportionate to include a review clause in this instrument because the estimated annual net direct cost to business is less than £5 million and the instrument does not apply to activities that are undertaken by small businesses.”

15. Contact

- 15.1 Kieran Davis at HM Treasury (Telephone: 07977 956689, or email: Kieran.Davis@hmtreasury.gov.uk) can be contacted with any queries regarding the instrument.
- 15.2 John ORegan, Deputy Director for [the Policy area], at HM Treasury, can confirm that this Explanatory Memorandum meets the required standard.
- 15.3 Bim Afolami MP, 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 and the European Union (Future Relationship) Act 2020

Part 1A

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) or 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
Appropriateness	Sub-paragraph (2) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1) or 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) or 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) or 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) or 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 IP completion 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) or	Set out the 'good reasons' for creating a criminal offence, and the penalty attached.

		23(1) or jointly exercising powers in Schedule 2 to create a criminal offence	
Sub-delegation	Paragraph 30, Schedule 7	Ministers of the Crown exercising section 8 or 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 5 or 19, Schedule 7.	Statement of the reasons for the Minister's opinion that the SI is urgent.
Scrutiny statement where amending regulations under 2(2) ECA 1972	Paragraph 14, Schedule 8	Anybody making an SI after IP completion day under powers conferred before the start of the 2017-19 session of Parliament 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.
Explanations where amending regulations under 2(2) ECA 1972	Paragraph 15, Schedule 8	Anybody making an SI after IP completion 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 IP completion day, and explaining the instrument's effect on retained EU law.

Part 1B

Table of Statements under the 2020 Act

This table sets out the statements that may be required under the 2020 Act.

Statement	Where the requirement sits	To whom it applies	What it requires
Sifting	Paragraph 8 Schedule 5	Ministers of the Crown exercising section 31 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