EXPLANATORY MEMORANDUM TO

THE CENTRAL COUNTERPARTIES (TRANSITIONAL PROVISION) (EXTENSION AND AMENDMENT) REGULATIONS 2023

2023 No. 999

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 extends the temporary recognition regime ("TRR") for third country[1] central counterparties ("CCPs") by 12 months, so that the expiry date is delayed until 31 December 2025. This will allow third country CCPs in the regime to continue to offer clearing services in the UK whilst they wait for their applications for recognition to be determined by the Bank of England ("the Bank").

2.2 It also extends the transitional regime for qualifying CCPs ("QCCPs") contained within the Capital Requirements Regulation ("CRR") for an additional 12 months. The expiry date of this transitional regime differs between individual CCPs as it is dependent on when a firm has applied for recognition in the UK. However, for a large percentage of firms within the regime, the expiry date currently falls on 31 December 2023.

2.3 The QCCP transitional regime ensures that UK firms with indirect exposures to these QCCPs can continue to benefit from favourable capital treatment. "Indirect exposures" could occur, for example, where a UK firm receives clearing services from the relevant third country CCP via another firm. The extension will ensure that UK firms with indirect exposures to the QCCPs within the regime will not face a sudden and disruptive increase in their capital requirements on the expiry of the QCCP transitional regime.

2.4 HMT previously extended the TRR and the QCCP transitional regime by 12 months in the Central Counterparties (Transitional Provision) (Extension and Amendment) Regulations 2022 (the "2022 Extension Regulations")[2].

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 whole United Kingdom.

[1] "Third country" means a country other than the United Kingdom (see regulation 11 of S.I. 2018/1184).
[2] The Central Counterparties (Transitional Provision) (Extension and Amendment) Regulations 2022 - Explanatory Memorandum (legislation.gov.uk).

4.2 The territorial application of this instrument (that is, where the instrument produces a practical effect) is the whole 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

Amendment relating to the Temporary Recognition Regime (TRR)

6.1 The UK's regulatory framework for CCPs is set out primarily in the European Market Infrastructure Regulation ("EMIR"), as retained in domestic UK law by virtue of the European Union (Withdrawal) Act 2018 ("EUWA 2018") and amended by regulations made under section 8 of the EUWA 2018. This legislation, as amended and forming part of retained EU law, is referred to in this explanatory memorandum as UK EMIR. UK EMIR lays down rules on over-the-counter ("OTC") derivatives and trade repositories, as well as CCPs.

6.2 The Central Counterparties (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018[3] (the "CCP Regulations") is one of the statutory instruments that amended UK EMIR in order to deal with deficiencies arising from the withdrawal of the UK from the EU. Regulations 11 to 26 provide for the TRR, enabling third country CCPs to continue to offer their clearing services in the UK for a set period after the end of the transition period ("TP"). This period was originally set to last for three years (i.e. until 31 December 2023) but was extended by 12 months by the 2022 Extension Regulations. There have been several other instruments made under section 8 of EUWA 2018 which have made amendments to UK EMIR to ensure it continues to function effectively for UK markets.

6.3 This instrument makes an amendment to regulation 18 of the CCP Regulations, to allow third country CCPs within the TRR to continue providing clearing services into the UK for an additional 12 months beyond 31 December 2024. Regulation 18(2) of the CCP Regulations gives HM Treasury power to extend this period for up to 12 months at a time, if satisfied that it is necessary and proportionate to do so to avoid disruption to the financial stability of the United Kingdom. This is the second time this power has been exercised.

Amendment relating to the QCCP transitional regime

6.4 The CRR, as retained in domestic law by virtue of the EUWA 2018, is a core part of the UK's prudential regulation regime for banks, building societies and investment firms. The CRR sets out various minimum requirements including standards on the amounts of capital that firms must hold against different types of exposures.

[3] SI 2018/1184. SI 2020/56 amended these regulations to provide for the period of the TRR to be calculated by reference to the end of the transition period, instead of exit day. These regulations were also amended by SI 2020/648 and SI 2022/1080.

6.5 The CRR was extensively amended as a result of the UK's exit from the EU, by regulations[4] made in exercise of the powers in section 8 of the EUWA 2018. These ensure it continues to operate effectively for UK markets.

6.6 Article 497 of the CRR establishes a transitional period during which institutions may treat exposures to certain third country CCPs as exposures to QCCPs after the relevant CCP has submitted an application for recognition. This three-year period is referred to as the "QCCP transitional regime" in this explanatory memorandum, and was initially put in place by the EU to ensure continuity for EU firms with exposures to third country CCPs, while both jurisdictional equivalence and CCP recognition were being determined. By retaining the regime following the UK's exit from the EU, UK authorities aimed to guarantee continuity for UK firms with exposures to these CCPs, whilst also ensuring a smooth transition to the UK's new regulatory framework. This was intended to provide certainty and stability to participants in international financial markets.

6.7 Article 497 was amended by the Capital Requirements Regulation (Amendment) (EU Exit) Regulations 2019[5] and the Capital Requirements Regulation (Amendment) (EU Exit) Regulations 2021[6], to ensure it continues to operate effectively following the withdrawal of the United Kingdom from the EU. These amendments include providing that (i) a power for the EU Commission to extend this QCCP transitional period by 12 months, in exceptional circumstances, where it is necessary and proportionate in order to avoid disruption to the international financial markets, is transferred to, and is exercisable by, HM Treasury, and (ii) that it can be exercised on more than one occasion. HM Treasury exercised this power for the first time in the 2022 Extension Regulations and is now extending the transitional period a second time in this instrument.

6.8 The period for which a CCP could have QCCP status under the QCCP transitional regime was originally two years. It was extended by 12 months by the 2022 Extension Regulations. HM Treasury is now extending the transitional period for a further 12 months in this instrument.

7. Policy background

7.1 CCPs are used by firms to reduce certain risks that arise when trading on financial markets, such as derivatives and equities markets. They sit between the buyers and sellers of financial instruments, 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 global financial transactions.

7.2 Article 25 of UK EMIR establishes that a third country CCP may provide clearing services to clearing members or trading venues established in the UK where that third country CCP has been recognised by the Bank.

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[4] These include: Capital Requirements Regulation (Amendment) (EU Exit) Regulations 2018, Capital Requirements Regulation (Amendment) EU Exit) Regulations 2019 and Capital Requirements Regulation (Amendment) EU Exit) Regulations 2021.

[5] SI 2019/1232

[6] SI 2021/558

7.3 The government did not incorporate into domestic UK law the equivalence decisions for CCPs that the EU had made under Article 25 of EMIR prior to the UK's withdrawal from the EU. Following EU exit, HM Treasury was given the responsibility to undertake new assessments for all third country jurisdictions, in order to determine whether, in specific areas of financial services regulation, another jurisdiction's regulatory and supervisory frameworks can be deemed equivalent to the UK.

7.4 The Bank of England is responsible for making the decision to recognise individual CCPs within a jurisdiction deemed to be equivalent, once the Bank has completed a recognition assessment. This, in turn, enables UK clearing members and trading venues to use the clearing services of that CCP. This serves to facilitate cross-border financial services activity in relation to that equivalent jurisdiction by permitting market access and reducing regulatory frictions or costs to firms.

Amendment relating to the Temporary Recognition Regime (TRR)

7.5 Since the end of the TP, the TRR has ensured that third country CCPs are able to continue to provide services in the UK, provided that they were recognised in the EU under EMIR before the end of the TP (and continue to be so recognised), and had notified the Bank that they intended to continue to do so in the UK post-TP. The TRR is currently due to expire on 31 December 2024, having been extended by 12 months by the 2022 Extension Regulations.

7.6 The Financial Services (Miscellaneous Amendments) (EU Exit) Regulations 2022[7] expanded the scope of the TRR, by allowing third country CCPs that were already in the TRR to offer new products. This is in addition to the classes of financial instrument in which the relevant third country CCP was already permitted to offer products whilst in the TRR, provided that the relevant third country CCP is permitted to offer those new clearing products in the country in which they are established and that they have notified the Bank of England of their intention to offer these products in the UK.

Amendment relating to the QCCP transitional regime

7.7 Third country CCPs can also benefit from another form of preferential status, known as "qualifying CCP", or QCCP, status. QCCP status alone does not allow third country CCPs to provide services directly to UK firms or trading venues. Instead, where applicable, it ensures that UK firms are not subject to higher capital requirements for any indirect exposures they have to the relevant CCP. As set out in paragraph 2.3, UK firms will have an indirect exposure to the CCP if, for example, a UK firm receives clearing services "indirectly" from the relevant third country CCP. This means when the UK firm receives clearing services from the CCP via another firm as a 'client', as opposed to being a direct 'clearing member' of the CCP itself.

7.8 Regardless of whether a CCP is classified as a QCCP or not, a clearing member retains the responsibility to ensure that it maintains adequate capital for its exposures towards it. However, under the CRR, the capital requirements for exposures to QCCPs are much less onerous than for exposures to non-QCCPs. The higher capital charges for UK firms with exposures to a third country CCP that does not benefit from QCCP status would likely prohibit continuation of business with that CCP, as the higher capital requirements would render it uneconomic.

[7] SI 2022/1080

7.9 There are multiple ways in which a third country CCP can be granted QCCP status. Firstly, third country CCPs that are recognised under Article 25 UK EMIR are automatically granted QCCP status. Secondly, as third country CCPs within the TRR are treated as if recognised under Article 25 UK EMIR, they also benefit from QCCP status whilst they are in that regime. There is also a time limited "run-off" regime in place for CCPs which enter the TRR but then subsequently exit the regime without permanent recognition. CCPs retain market access into the UK and continue to benefit from QCCP status whilst they are in the run-off regime (for a maximum period of three and a half years).

7.10 Finally, there is the QCCP transitional regime, which this statutory instrument is extending. Unlike the previous two regimes, this does not allow for direct market access. The transitional regime, which, as outlined in paragraph 6.6, sits within Article 497 of the CRR, allows a CCP that has submitted an application for recognition under Article 25 UK EMIR to be treated as if it were a QCCP for three years. This period was originally set to be two years but was subsequently extended by 12 months by the 2022 Extension Regulations. The expiry date of the QCCP transitional regime for each individual CCP, after which a CCP no longer benefits from QCCP status, depends on several factors, including when firms submitted their recognition applications, and whether equivalence has been granted by HMT in relation to that CCP's home jurisdiction. As of the laying date of this SI, the UK has not granted Article 25 UK EMIR equivalence to the home jurisdictions of the firms within the QCCP transitional regime.

7.11 CCPs that submitted their application for recognition before the end of the TP are treated as though their application was submitted at the end of the TP at 11pm on 31 December 2020, which grants them QCCP status for three years until 31 December 2023. This accounts for a significant percentage of firms in the QCCP regime. For firms which submitted their application after the end of the TP, the transitional expires at a later date – which is to say three years after the application was submitted.

What is being done and why?

Amendment relating to the Temporary Recognition Regime (TRR)

7.12 In January 2020, new provisions in EMIR came into force that created a much more complex process for recognising third country CCPs than was previously the case. The key change introduced process is the "tiering" of third country CCPs according to the financial stability risk that they pose, with more extensive recognition requirements imposed on those CCPs that are, or are likely to become, systemically important.

7.13 When EMIR became part of retained EU law, the Bank was given responsibility for finalising policy on important areas of this more complex procedure, and has subsequently consulted on, and implemented, the new recognition process in the UK. This required significant amounts of time and resource to complete, as well as being subject to resourcing pressures caused by the COVID-19 pandemic, which delayed progress.

7.14 As a result of the number of equivalence decisions to be made, as well as the incorporation of this new "tiering" process into UK law, some third country CCPs will not receive permanent recognition within the timescales originally anticipated. HMT therefore extended the TRR by a period of 12 months in the 2022 Extension

Regulations, which is the maximum period which Regulation 18(2) of the CCP Regulations allowed.

7.15 Since the 2022 Extension Regulations were made, the Financial Services and Markets Act 2023 (FSMA 2023) has been passed. This significant piece of legislation puts in place a clear framework for a Smarter Regulatory Framework for the Bank of England in its regulation and supervision of UK CCPs. This includes new objectives for the Bank and provisions for the future framework for providing market access for third country CCPs. Once the relevant provisions of FSMA 2023 have been commenced, the Bank will be empowered to create a rulebook for CCPs, while HM Treasury will need to pass further legislation amending the EMIR framework as part of the Smarter Regulatory Framework process. The TRR has ensured that market access continues on a status quo basis while this work continues.

7.16 Over this period, HM Treasury has also made an equivalence determination in respect of the regulatory framework that applies to certain CCPs established in India and authorised by the Reserve Bank of India. The Bank has also recognised several CCPs within the TRR[8], thus moving them out of the regime. HM Treasury is continuing to progress equivalence decisions alongside the work being conducted to embed the Smarter Regulatory Framework, but an extension of the TRR is necessary for some third country CCPs to be able to continue their activities in the UK after the current expiry date of the TRR (31 December 2024).

7.17 This instrument therefore extends the TRR by a further period of 12 months (until 31 December 2025), to ensure that the third country CCPs within it are able to continue their activities in the UK, whilst they await a decision on their application for recognition. This will avoid these firms facing a sudden loss of market access into the UK at the end of 2024. It will also avoid UK clearing members being suddenly unable to continue using these CCPs, requiring them to 'off-board' their positions, which could be costly and risky especially if done at pace. The TRR was put in place to prevent this outcome and the accompanying disruption to firms and markets, and to the UK's financial stability. The TRR continues to fulfil this role, and it is therefore necessary to extend the temporary recognition period.

7.18 This extension is also proportionate, as it will ensure that the TRR will continue to operate as intended, and in a way in which third country CCPs and their UK users expect, beyond the end of 2024. It will provide certainty to business and avoid undesirable outcomes which could disrupt international financial markets and cause risks to UK and international financial stability. It also does not result in any significant additional burden on UK or overseas firms.

Amendment relating to the QCCP transitional regime

7.19 The QCCP transitional regime is due to expire at the end of 2023 for a significant percentage of CCPs within the regime. If it does, UK firms with exposures to the CCPs within this regime will face a sudden increase in their capital requirements.

7.20 This instrument therefore extends the time period for which third country CCPs possess QCCP status after submitting an application for recognition, from three years post submission to four years. This will avoid disruption at the point that the transitional period expires (the end of 2023 for a significant percentage of firms) and

[8] A list of recognised CCPs can be found on this page: [Financial market infrastructure supervision | Bank of England]

allow UK authorities additional time to progress the outstanding pipeline of equivalence and recognition decisions for third country jurisdictions and CCPs.

7.21 As explained in paragraph 6.8, this QCCP regime was originally two years but was extended to three years by the 2022 Extension Regulations. This 12-month extension is the maximum extension available under HM Treasury's powers, as set out in Article 497(3) of the CRR.

7.22 HM Treasury's power to extend the time limits set out in 497(1) of the CRR is exercisable in exceptional circumstances, where it is necessary and proportionate in order to avoid disruption to international financial markets.

7.23 The extension power was originally designed by the EU to be used in a scenario where they were processing a limited number of applications for recognition from third country CCPs (many of whom would be coming from an equivalent jurisdiction). However, following EU exit, UK authorities need to carry out equivalence assessments and make recognition decisions not only for any new firms that apply, but also for any jurisdiction that benefitted from equivalence and any firm that benefitted from recognition in the EU prior to EU exit. These exceptional circumstances arose due to EU exit and still persist.

7.24 Without an extension there is a risk of disruption to international financial markets. By extending the regime, UK firms with exposures to a QCCP will avoid a sudden increase in their capital requirements, as their exposures would then relate to a non-QCCP. This may lead to firms trying to unwind their positions, leading to uncertainty and disruption in international financial markets. Extending the transitional regime by an additional twelve months is a proportionate way of addressing these risks. It does not impose any significant burden on UK or third country firms, and will simply maintain the status quo for an additional, time-limited period.

7.25 In its 24th Report published on 30 November 2022[9], the House of Lords' Secondary Legislation Scrutiny Committee drew the 2022 Extension Regulations to the House's attention, noting concerns around the operation of the QCCP transitional regime. The committee judged that the regime created a risk that an unsuitable firm could benefit from QCCP status given that there are no initial checks or ongoing oversight of firms benefitting from the QCCP transitional regime. The committee encouraged HM Treasury to consider reforming the regime before extending the regime further.

7.26 As set out in HM Treasury's response to the committee's original questions on the operation of the regime[10], there are several factors that would, in practice, limit the risk of an unsuitable firm benefitting from the regime. However, HM Treasury agrees with the committee's position that the regime is in need of reform.

7.27 FSMA 2023 repeals retained EU law relating to financial services. This enables the government to deliver a Smarter Regulatory Framework for financial services. Retained EU law will be repealed and replaced with rules set by our independent and expert regulators, operating within a framework set by government and Parliament. As the transitional is a part of retained EU law, HM Treasury believes this reform is most appropriately done as part of the wider programme of delivering the Smarter Regulatory Framework. This will also align changes to the QCCP transitional regime

[9] House of Lords - Twenty Fourth Report - Secondary Legislation Scrutiny Committee (parliament.uk)
[10] House of Lords - Twenty Fourth Report - Secondary Legislation Scrutiny Committee (parliament.uk)

with the significant changes to the legal framework for CCP regulation made by FSMA 2023.

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 currently no plans to consolidate the relevant legislation.

10. Consultation outcome

10.1 A public consultation was not undertaken for these amendments as these are small technical amendments, which make use of the powers in the legislation to extend the length of two transitional regimes by 12 months.

10.2 HM Treasury has engaged with the Bank of England and the Financial Conduct Authority on these issues.

11. Guidance

11.1 HM Treasury does not propose to provide any guidance in relation to 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 the impact of this SI is small (the cost to businesses is < £5m per year). A de minimis Impact Assessment is submitted with this memorandum and published alongside the Explanatory Memorandum on the legislation.gov.uk website.

13. Regulating small business

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

13.2 The amendments made by this instrument are not expected to have an impact on small businesses, and therefore no action is needed to mitigate the impact on them.

14. Monitoring & review

14.1 The regulation 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 HM Treasury (Andrew Griffith) has made the following statement:

“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 number of small businesses in scope is very low.”

15. Contact

15.1 Alexander Edwards at HM Treasury (email: alexander.edwards@hmtreasury.gov.uk) can be contacted with any queries regarding the instrument.

15.2 Tom Duggan, Deputy Director for Securities and Markets at HM Treasury, can confirm that this Explanatory Memorandum meets the required standard.

15.3 Andrew Griffith, Economic Secretary to HM Treasury, can confirm that this Explanatory Memorandum meets the required standard.