

EXPLANATORY MEMORANDUM TO

THE CENTRAL COUNTERPARTIES (EQUIVALENCE) REGULATIONS 2020

2020 No. 1244

1. Introduction

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

2. Purpose of the instrument

- 2.1 This instrument is being made in order to specify that the legal and supervisory arrangements for Central Counterparties (CCPs) in the European Economic Area (EEA) meet at least equivalent outcomes to the UK's corresponding regime. This instrument, and the subsequent recognition by the Bank of England that it enables, will allow UK businesses and trading venues to continue using the clearing services of EEA CCPs under the European Market Infrastructure Regulation (EMIR) after the end of the Temporary Recognition Regime.
- 2.2 These regulations are being made under Regulation 14 of the Central Counterparties (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018 (SI 2018/1184) (TRR SI) following an assessment of the legal and supervisory framework applicable to EEA CCPs. At the end of the Transition Period (11 pm on 31 December), they will have effect as if made under Article 25.6 EMIR as retained EU law under ss. 2, 3, 4, and 7 of the European Union (Withdrawal) Act 2018 (EUWA).

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 None.

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

- 3.2 As the instrument is subject to negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

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

6. Legislative Context

- 6.1 Under EU law, the regime for recognition of third country CCPs is set out in Article 25 EMIR.

- 6.2 At the end of the Transition Period the EUWA will convert into UK domestic law the existing body of EU law that is directly applicable and in force before the end of the Transition Period (retained EU law). This includes most of the EMIR framework.
- 6.3 Section 8 EUWA empowers HM Treasury to address ‘deficiencies,’ in retained law to ensure it will continue to operate effectively in a UK-only context at the end of the Transition Period. A number of EU Exit regulations ‘fix’ the functioning of EMIR under UK law.
- 6.4 At the end of the Transition Period, EMIR as retained EU law, and with the changes made through primary and secondary legislation, will form part of UK legislation.
- 6.5 The TRR SI and the Over the Counter Derivatives, Central Counterparties and Trade Repositories Amendment, etc., and Transitional Provision (EU Exit) Regulations 2020 (SI 2020/646) address deficiencies in EMIR and makes transitional provision in relation to the provision of clearing services in the UK by foreign CCPs.
- 6.6 First, to ensure the continuity of services provided by foreign CCPs, the TRR SI created a ‘Temporary Recognition Regime’ allowing UK businesses and trading venues to continue using the clearing services of foreign CCPs for a period of three years maximum following the end of the Transition Period.
- 6.7 Second, the TRR SI adapts the procedure for granting jurisdictional equivalence and recognition of third country CCPs set out in Article 25 EMIR, making it suitable for a UK-only context. The TRR SI empowers HM Treasury to determine whether a foreign jurisdiction’s regulatory regime for CCPs is ‘equivalent’ to the UK, i.e., determine that the regulatory and supervisory requirements of a regime located outside the UK are robust enough to deliver the same outcomes as the UK regime. The Bank of England can subsequently assess the CCPs in that jurisdiction and make a ‘recognition’ decision, i.e., determine that UK businesses and trading venues may use the clearing services of EEA CCPs after the end of the Temporary Recognition Regime. This decision is made at firm level. This new regime will come into force at the end of the Transition Period.
- 6.8 Regulations 14-15 of the TRR SI, under which these regulations are made, also set out a temporary regime under which HM Treasury may make equivalence determinations before the end of the Transition Period. As of the end of the Transition Period, the decisions taken – and advice given – under these regulations will be treated as made under Article 25 EMIR.

7. Policy background

What is being done and why?

- 7.1 A CCP is used by firms to manage counterparty risk when trading derivative contracts or securities. 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 or security in order to guarantee the performance of the contract. This means the CCP will ensure the contract is honoured even if one of the parties goes into default. This process of guaranteeing transactions is referred to as ‘clearing’.
- 7.2 In 2009, the G20 made a commitment to ensure that derivative trades would be cleared on CCPs. EMIR implements this commitment in the UK and mandates the use

of CCPs for certain over-the-counter derivative transactions (traded directly between two parties).

- 7.3 Under EU law, firms can use any EU CCP to meet their clearing obligations. Clearing services can only be provided by third countries CCPs that are recognised by ESMA and the Commission through the procedure set out in Article 25 EMIR.
- 7.4 The TRR SI adapts the procedure in Article 25 EMIR to a UK-only context. HM Treasury has received technical advice from the Bank of England as part of HMT's decision-making process. HMT asked the Bank of England to take forward a proportionate approach to preparing technical advice on the EEA taking into account our unique starting point as a former Member State. In its advice, the Bank of England advised that on balance it considered the legal and supervisory framework equivalent to that of the UK.
- 7.5 HM Treasury is therefore satisfied that the legal and supervisory framework in the EEA states meets at least equivalent outcomes to the ones provided in the UK's corresponding regime.

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

- 8.1 As a result of the withdrawal of the United Kingdom from the European Union, EEA member state authorisation of CCPs is no longer sufficient for them to be authorised in the UK.
- 8.2 Therefore, UK firms will be reliant on the Temporary Recognition Regime, and subsequently a UK equivalence and recognition determination, to be able to use foreign CCPs.

9. Consolidation

- 9.1 This instrument does not consolidate any other instrument.

10. Consultation outcome

- 10.1 HM Treasury has not undertaken a consultation on the instrument.

11. Guidance

- 11.1 HM Treasury does not propose to provide any guidance in relation to these Regulations. 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 existing UK clearing members of EEA CCPs may wish to familiarise themselves with the determination made by HM Treasury, this instrument ensures that EEA CCPs can continue to provide the services to UK firms that they do currently, and will not create any new operational requirements for UK firms.
- 12.2 There is no, or no significant, impact on the public sector.
- 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 £5 million a year. This is because this determination maintains the

current status quo for UK firms using EEA CCPs. Moreover, an equivalence determination in itself does not grant market access or regulatory benefits for EEA CCPs; rather, this is achieved through a recognition decision from the Bank of England, and the establishment of cooperation agreements with the relevant EEA competent authority. 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. The permission for UK businesses and trading venues to use the clearing services of EEA CCPs after the end of the Temporary Recognition Regime will result from decisions taken independently by the Bank of England.

14. Monitoring & review

- 14.1 As set out in the Memorandum of Understanding between HM Treasury, the Bank of England, 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.¹ 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.

15. Contact

- 15.1 Youri Dayot at HM Treasury Telephone: 020 7270 5804 or email: youri.dayot@HMTreasury.gov.uk can be contacted with any queries regarding the instrument.
- 15.2 Tom Duggan, Deputy Director for Securities, Markets and Banking, at 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.

¹ <https://www.gov.uk/government/publications/memorandum-of-understanding-equivalence-and-exemptions>