EXPLANATORY MEMORANDUM TO

THE CENTRAL COUNTERPARTIES (TRANSITIONAL PROVISION) (EXTENSION AND AMENDMENT) REGULATIONS 2024

2024 No. 923

1. Introduction

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

2. Declaration

2.1 Tulip Siddiq, Economic Secretary at HM Treasury, confirms that this Explanatory Memorandum meets the required standard.

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

3. Contact

3.1 Alexander Edwards at HM Treasury [alexander.edwards@hmtreasury.gov.uk] can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 This instrument extends the temporary recognition regime ("TRR") for overseas central counterparties ("CCPs") by 12 months, so that the expiry date is delayed until 31 December 2026. This will allow overseas 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").

4.2 It also extends the transitional regime for overseas qualifying CCPs ("QCCPs") contained within the Capital Requirements Regulation[1] 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 2024.

4.3 The transitional regime for QCCPs ensures that UK firms with indirect exposures to these overseas CCPs can continue to benefit from favourable capital treatment. "Indirect exposures" could occur, for example, where a UK firm receives clearing services from the relevant overseas CCP via another overseas 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.

4.4 HM Treasury has previously extended the TRR and the QCCP transitional regime twice, by 12 months each time, in the Central Counterparties (Transitional Provision)

[1] Regulation (EU) 575/2013

(Extension and Amendment) Regulations 2022 (the "2022 Extension Regulations")[2] and the Central Counterparties (Transitional Provision) (Extension and Amendment) Regulations 2023 (the "2023 Extension Regulations")[3].

Where does the legislation extend to, and apply?

4.5 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is England and Wales, Scotland, and Northern Ireland.

4.6 The territorial application of this instrument (that is, where the instrument produces a practical effect) is England and Wales, Scotland, and Northern Ireland.

5. Policy Context

What is being done and why?

5.1 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 certain 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.

5.2 The UK's regulatory framework for CCPs is set out primarily in the European Market Infrastructure Regulation ("EMIR"), as set out in assimilated 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 assimilated EU law, is referred to in this explanatory memorandum as "UK EMIR". UK EMIR lays down rules on over-the-counter derivatives and trade repositories, as well as CCPs.

5.3 Article 25 of UK EMIR establishes that an overseas CCP may provide clearing services to clearing members (i.e., the direct members of the CCP) or trading venues established in the UK where the jurisdiction it is in has been deemed equivalent by the Treasury and the overseas CCP has been recognised by the Bank.

5.4 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 overseas jurisdictions, to determine whether, in specific areas of financial services regulation, another jurisdiction's regulatory and supervisory frameworks can be deemed equivalent to the UK's.

5.5 The Bank 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.

[2] The Central Counterparties (Transitional Provision) (Extension and Amendment) Regulations 2022 (legislation.gov.uk)
[3] The Central Counterparties (Transitional Provision) (Extension and Amendment) Regulations 2023 (legislation.gov.uk)

Amendment relating to the Temporary Recognition Regime (TRR)

5.6 The Central Counterparties (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018[4] (the "CCP Regulations") is one of the statutory instruments that amended UK EMIR to deal with deficiencies arising from the withdrawal of the UK from the EU. Regulations 11 to 26 provide for the TRR which ensured that overseas CCPs were able to continue to provide services in the UK for a set period after end of the transition period ("TP"), provided that the overseas CCPs 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 provide services in the UK post-TP. It was put in place to provide the government with the necessary time to put in place a new regulatory regime for domestic and overseas CCPs. The TRR was originally set to last for three years (i.e., until 31 December 2023).

5.7 However, in January 2020, new provisions in the EU's EMIR came into force that created a much more complex process for recognising overseas CCPs than was previously the case. The key change introduced to this process was the "tiering" of overseas 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.

5.8 This additional process set out in paragraph 5.7 also became part of assimilated EU law. When EMIR became part of assimilated EU law, the Bank was given responsibility for finalising the UK's 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.

5.9 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 overseas CCPs did not receive permanent recognition within the timescales originally anticipated. HM Treasury therefore extended the TRR by a period of 12 months in the 2022 Extension Regulations and another 12 months in the 2023 Extension Regulations. An extension of 12 months is the maximum period which Regulation 18(2) of the CCP Regulations allows.

5.10 HM Treasury has continued to make progress in relation to equivalence decisions for overseas jurisdictions with CCPs within the TRR. Since the 2023 Extension Regulations were made in late 2023, HM Treasury has made further equivalence determinations in relation to Singapore[5] and the Commodity Futures Trading Commission[6] in the US.

5.11 HM Treasury has also, in the Financial Services and Markets Act 2023 ("FSMA 2023"), prioritised putting in place an entirely new framework for the Bank to regulate and supervise UK and overseas CCPs. This included new statutory objectives for the Bank and provisions for the future framework for providing market access for third country CCPs. The relevant provisions of FSMA 2023 were then commenced on 1 Jan

[4] S.I. 2018/1184. S.I. 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 S.I. 2020/646 and S.I. 2022/1080.

[5] The Central Counterparties (Equivalence) (Singapore) (Monetary Authority of Singapore) Regulations 2023 (legislation.gov.uk)

[6] The Central Counterparties (Equivalence) (United States of America) (Commodity Futures Trading Commission) Regulations 2023 (legislation.gov.uk)

2024, bringing into force the Bank's new rule-making powers over CCPs which can be used to set out the regulatory framework for these firms once the revocation of relevant CCP provisions in EMIR under FSMA 2023 is commenced.

5.12 HM Treasury is continuing to progress equivalence decisions 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 2025). An extension will also ensure market access continues a status quo basis whilst work continues to embed the new regulatory framework for CCPs.

5.13 This instrument therefore extends the TRR by a further period of 12 months (until 31 December 2026), to ensure that the overseas CCPs within it can 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 2025.

5.14 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.

5.15 This extension is also proportionate, as it will ensure that the TRR will continue to operate as intended, and in a way in which overseas CCPs and their UK users expect, beyond the end of 2025. 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

5.16 Overseas CCPs can also benefit from another form of preferential status, known as "qualifying CCP", or QCCP, status. QCCP status alone does not allow overseas 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 4.3, UK firms will have an indirect exposure to the CCP if a UK firm receives clearing services "indirectly" from the relevant overseas CCP. For example, this would capture 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.

5.17 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 the CCP. However, 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.

5.18 There are multiple ways in which an overseas CCP can be granted QCCP status. Firstly, overseas CCPs that are recognised under Article 25 of UK EMIR are automatically granted QCCP status. Secondly, as overseas 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).

5.19 Finally, there is the transitional regime (the "QCCP transitional regime") which this statutory instrument extends. This regime is set out within Article 497 of the Capital Requirements Regulation ("CRR"), as set out in assimilated law by virtue of the EUWA 2018. The CRR is a core part of the UK's prudential regulation regime for banks, building societies and investment firms. It sets out various minimum requirements including standards on the amounts of capital that firms must hold against different types of exposures.

5.20 The QCCP transitional regime establishes a transitional period during which institutions may treat exposures to certain overseas CCPs as exposures to QCCPs after the relevant CCP has submitted an application for recognition. This period was initially put in place by the EU to ensure continuity for EU firms with exposures to overseas CCPs, while both jurisdictional equivalence and CCP recognition were being determined. By retaining the regime in assimilated law 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.

5.21 This period was originally set to be two years in the UK's assimilated regime but was subsequently extended by 24 months in total by the 2022 Extension Regulations and 2023 Extension Regulations. A 12-month extension is the maximum extension available for each SI under HM Treasury's powers, as set out in Article 497(3) of the CRR.

5.22 CCPs that submitted their application for recognition before the end of the TP, which accounts for a significant percentage of the firms within the regime, are treated as though their application was submitted at the end of the TP at 11pm on 31 December 2020. These firms therefore have QCCP status for four years until 31 December 2024. For firms which submitted their application after the end of the TP, the transitional expires later – which is to say four years after the application was submitted.

5.23 As the QCCP transitional regime is due to expire at the end of 2024 for a significant percentage of CCPs within the regime, UK firms with exposures to the CCPs within this regime are at risk of facing a sudden increase in their capital requirements.

5.24 This instrument therefore extends the time period for which overseas CCPs possess QCCP status after submitting an application for recognition, from four years post submission to five years. This will avoid disruption at the point that the transitional period expires (the end of 2024 for a significant percentage of firms) and allow UK authorities additional time to progress the outstanding pipeline of equivalence and recognition decisions for overseas jurisdictions and CCPs.

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

5.26 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 overseas 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 persist.

5.27 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 overseas firms, and will simply maintain the status quo for an additional, time-limited period.

5.28 The House of Lords' Secondary Legislation Scrutiny Committee in its 24th Report published on 30 November 2022[7] and 53rd Report published on 19 October 2023[8] drew the House's attention to the 2022 Extension Regulations and 2023 Extension Regulations respectively. In these reports, the Committee noted concerns around the operation of the QCCP transitional regime on the basis that there was a risk that an unsuitable CCP could enter the regime, and benefit from QCCP status, without checks or ongoing oversight of their activities. The committee encouraged HM Treasury to consider reforming the regime before extending the regime further.

5.29 HM Treasury responded to questions on this topic posed by the committee as part of the 24th Report[9], setting out its view that there are several factors that would, in practice, limit the risk of an unsuitable firm benefitting from the regime. These factors included the expectation that UK firms with exposures to the CCP, and the intermediaries sitting between the two, would take appropriate measures to monitor and effectively manage their exposures. The UK firms are also subject to PRA supervision and the PRA works with firms to ensure that they are appropriately managing their risks. UK firms must also always ensure their compliance with all relevant laws and regulation. Nevertheless, as set out in the explanatory memorandum to the 2023 Extension Regulations, HM Treasury agrees with the committee's position that the regime needs reform.

5.30 FSMA 2023 repeals assimilated law relating to financial services, subject to commencement by HM Treasury. Assimilated law will be replaced with rules set by our independent and expert regulators, operating within a framework set by government and Parliament. HM Treasury is undertaking work to repeal and replace the regulatory regime for CCPs that is currently in assimilated law. Changes to the QCCP regime will be taken forward as part of this wider programme of work, which will ensure that any changes align with the changes made elsewhere to the wider CCP regulatory regime.

What was the previous policy, how is this different?

5.31 As set out in paragraphs 5.6, 5.19 and 5.20, these transitional regimes were put in place on EU exit to guarantee continuity for firms. This SI represents a continuation of this policy.

[7] House of Lords - Twenty Fourth Report - Secondary Legislation Scrutiny Committee (parliament.uk)
[8] House of Lords - Fifty Third Report - Secondary Legislation Scrutiny Committee (parliament.uk)
[9] House of Lords - Twenty Fourth Report - Secondary Legislation Scrutiny Committee (parliament.uk)

6. Legislative and Legal Context

How has the law changed?

Amendment relating to the Temporary Recognition Regime (TRR)

6.1 This instrument makes an amendment to regulation 18 of the CCP Regulations, to allow overseas CCPs within the TRR to continue providing clearing services into the UK for an additional 12 months beyond 31 December 2025. 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.

6.2 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. The Financial Services (Miscellaneous Amendments) (EU Exit) Regulations 2022[10] 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 their intention to offer these products in the UK.

Amendment relating to the QCCP transitional regime

6.3 Article 497 of the CRR was amended by the Capital Requirements Regulation (Amendment) (EU Exit) Regulations 2019[11] and the Capital Requirements Regulation (Amendment) (EU Exit) Regulations 2021[12], 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 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.

6.4 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 both the 2022 Extension Regulations and the 2023 Extension Regulations. HM Treasury is now extending the transitional period for a further 12 months in this instrument.

Why was this approach taken to change the law?

6.5 This approach was taken given the existing powers in the CCP regulations and the CRR to extend these regimes. HM Treasury has not put in place a long-term replacement for the QCCP regime at this stage as this will be taken forward as part of this wider Smarter Regulatory Framework programme of work, which will ensure that any changes align with the changes made elsewhere to the wider CCP regulatory regime.

[10] S.I. 2022/1080
[11] S.I. 2019/1232
[12] S.I. 2021/558

7. Consultation

Summary of consultation outcome and methodology

7.1 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.

7.2 HM Treasury has engaged with the Bank and the Financial Conduct Authority on these issues.

8. Applicable Guidance

8.1 HM Treasury does not propose to provide any guidance in relation to this instrument.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A full Impact Assessment has not been prepared for this instrument because it maintains the effect of existing regulatory standards and the impact of this SI is small (the cost to businesses is < £10m per year). A de minimis Impact Assessment is submitted with this memorandum and published alongside the Explanatory Memorandum on the legislation.gov.uk website.

Impact on businesses, charities, and voluntary bodies

9.2 There is no, or no significant, impact on business, charities, or voluntary bodies because the SI maintains the effect of existing regulatory standards.

9.3 The legislation does not impact small or micro businesses.

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

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The instrument does not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015, Tulip Siddiq 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 £10 million."

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

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

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation

and Reform) Act 2023 ("relevant European Union Acts"). It does however relate to the withdrawal of the United Kingdom from the European Union because the legislation amends two transitional regimes that were established in the UK after EU-exit.