EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2023 (RESOLUTION OF CENTRAL COUNTERPARTIES: PARTIAL PROPERTY TRANSFERS AND SAFEGUARDING OF PROTECTED ARRANGEMENTS) REGULATIONS 2023

2023 No. [XXXX]

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 relates to the introduction of a new special resolution regime for central counterparties (CCPs) in Schedule 11 of the Financial Services and Markets Act 2023 (c. 29) (FSMA 2023). This legislation provides the necessary safeguards to ensure that certain types of contractual arrangements crucial to a CCP's operation, and to its clearing members and creditors, such as set-off and netting arrangements, are adequately protected when the Bank exercises its partial property transfer and write-down powers during a resolution.

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 England and Wales, Scotland and Northern Ireland.

4.2 The territorial application of this instrument is UK-wide.

5. European Convention on Human Rights

5.1 The Economic Secretary to the Treasury (Andrew Griffith) has made the following statement regarding Human Rights:

"In my view the provisions of the Financial Services and Markets Act 2023 (Resolution of Central Counterparties: Partial Property Transfers and Safeguarding of Protected Arrangements) Regulations 2023 are compatible with the Convention rights."

6. Legislative Context

6.1 The current resolution regime for central counterparties (CCPs) was introduced in 2014, under Part 1 of the Banking Act 2009 (c. 1) as applied to CCPs by sections 89B-89G of that Act.

6.2 Schedule 11 of FSMA 2023 (Schedule 11) introduced an expanded resolution regime for CCPs. This provides the Bank of England (the Bank), as the UK's Resolution Authority, with an expanded toolkit to mitigate the risk and impact of a CCP failure

and the subsequent risks to financial stability and public funds. This includes the power to make instruments transferring property (paragraphs 27 and 29 of Schedule 11) or to write down liabilities (paragraphs 34 and 35 of Schedule 11).

6.3 These Regulations apply in relation to partial property transfers (meaning a property transfer instrument which provides for the transfer of some but not all of the property, rights and liabilities of a CCP) (Parts 1 and 2) and in relation to the exercise of the write down power (Parts 1 and 3). Paragraphs 75(2) and (3), 76(2) to (4) and 78(3) to (5) of Schedule 11, confer powers on HM Treasury to make regulations which safeguard protected arrangements. Among other matters, regulations can be made imposing conditions or restrictions on the making of partial property transfers (paragraph 75), restricting the making of partial property transfers in cases involving protected arrangements (paragraph 76), and restricting the making of write-down instruments in cases that involve protected arrangements (paragraph 78). "Protected arrangements" means security interests, title transfer collateral arrangements, set-off arrangements and netting arrangements (all as defined in paragraphs 76 and 78 of Schedule 11).

6.4 These Regulations are based on legislation made under the equivalent powers in the Banking Act 2009: the Banking Act 2009 (Restriction of Partial Property Transfers) (Recognised Central Counterparties) Order 2014 (S.I. 2014/1828), and the Banking Act 2009 (Restriction of Special Bail-in Provision, etc.) Order 2014 (S.I. 2014/3350). The former of these Orders already applies to CCP resolution under the existing resolution regime, whilst the latter applies safeguards under the bank resolution regime to the use of the bail-in power, which has some similarities to the write-down power in Schedule 11.

6.5 Additionally, these Regulations use sections 47, 48 and 259(1) of the Banking Act 2009 to revoke the Banking Act 2009 (Restriction of Partial Property Transfers) (Recognised Central Counterparties) Order 2014. The revocation takes effect from the date upon which Schedule 11 is to come into force, other than in circumstances where a partial property transfer is made in relation to a CCP before that date, or where a CCP enters into resolution before that date and a partial property transfer is made after that date in reliance on any further consequential or transitional provision made under Section 83 or 84 of FSMA 2023.

7. Policy background

What is being done and why?

7.1 Under Schedule 11, the Bank is empowered to make property transfers (paragraphs 27 and 29), or to write-down liabilities (paragraphs 34). These powers have the potential to disrupt protected arrangements crucial to a CCP's operation, and to its clearing members and creditors, such as set-off and netting arrangements. As such, to minimise disruption to normal market functions, this legislation ensures safeguards are in place to avoid partial property transfers and write-down disrupting these arrangements. As set out above, the safeguards in relation to partial property transfers already exist within the previous CCP resolution regime, as enacted under the Banking Act 2009.

7.2 Taken together, these provisions ensure that the resolution action limits the disruption to usual market functions as far as possible. As noted above, this legislation follows similar provisions in the banking resolution regime.

7.3 Property transfer powers are set out in paragraphs 27 and 29 of Schedule 11. These provisions provide the Bank with the ability to transfer all or some of the property, rights or liabilities of a CCP. The write-down power is set out in paragraphs 34 and 35 of Schedule 11. It provides the Bank with the power to cancel, modify or change a security or the form of an unsecured liability which is owed to the CCP, and provisions that a contract under which the CCP has an unsecured liability is to have effect as if a specified right had been exercised under it.

7.4 Part 2 of these Regulations sets out the restrictions on the making of partial property transfers under Schedule 11. As noted above, this Part broadly replicates the existing legislation in the existing legislation in the Banking Act 2009 (Restriction of Partial Property Transfers) (Recognised Central Counterparties) Order 2014 (S.I. 2014/1828) for the purposes of the CCP resolution regime.

7.5 Regulation 2 (application of Part 2) sets out the three cases in which the partial property transfer restrictions apply: (i) where there is a partial property transfer; (ii) where there is a property transfer with a subsequent partial property transfer; and (iii) where there is a share transfer under paragraph 30(2) of Schedule 11 and a property transfer has been made by the Bank under paragraphs 71 or 72 of Schedule 11. Regulation 2 includes foreign property provisions to clarify that, where a property transfer instrument purports to have transferred all of the property, rights or liabilities of a CCP, it shall be treated as having done so effectively even if some of the property, rights or liabilities are foreign and there is a possibility they may not have been effectively transferred by the property transfer instrument by virtue of steps taken under paragraph 62 of Schedule 11 (foreign property).

7.6 Regulation 3 (protected rights and liabilities) defines 'protected rights and liabilities' by reference to the operation of the relevant default fund (single default fund or separate default funds for separate class or classes of financial instruments), by the CCP and how those rights and liabilities are recorded in the CCP's accounts. Broadly, this regulation provides that all the protected rights and liabilities between the CCP and a particular person must be transferred together, and that a partial property transfer to which the Regulations apply may not include provision under the continuity powers (as defined in regulation 1(4)) which terminates or modifies protected rights or liabilities between the CCP and those persons. The foreign property provisions also apply under regulation 3.

7.7 Regulation 4 (secured liabilities) ensures that a partial property transfer cannot separate from any transferred liability the benefit of any security that attaches to that liability (and vice versa). It ensures that the Bank cannot transfer the property or rights against which the liability is secured, unless that liability and the benefit of the security are also transferred. It also ensures that the partial property transfer to which these Regulations apply cannot include provision under the continuity powers which terminates or modifies the arrangement if the effect is that the liability is not secured against the property or rights. The foreign property provisions also apply under regulation 4. The restrictions in this regulation do not apply if the arrangement has been entered into by the CCP in contravention of any requirements set out in regulations made under Section 286(1) of the Financial Services and Markets Act 2000 (qualification for recognition), or any rules made pursuant to Section 286(4F)(b) or 300F of that Act (section 300F is inserted by Section 9 of FSMA 2023, and provides a power for the Bank to make rules relating to central counterparties and central securities depositories).

7.8 Regulation 5 (financial markets) provides that a partial property transfer may not transfer property, rights or liabilities or include provisions under the continuity powers to the extent that this would have the effect of modifying, modifying the operation of, or rendering unenforceable: a market contract; the default rules of an investment exchange, recognised clearing house, or recognised CSD (as defined by Section 285 of the Financial Services and Markets Act 2000; "CSD" is an abbreviation of "central securities depository"); or the rules of the aforementioned institutions as to the settlement of market contracts not dealt with under its default rules.

7.9 Regulation 6 ("trusts") places limitations on the exercise of the power provided in paragraph 55(7)(a) of the Schedule (effect of property transfer instrument), where the transfer is a partial property transfer instrument. Paragraph 55(7)(a) provides that where a property transfer instrument makes provision regarding property held on trust, the instrument may remove or alter the terms of any trust upon which the transferred property was held prior to the transfer. Regulation 6 provides that, in the context of a partial property transfer, this can only be done to the extent necessary or expedient for the purpose of transferring from the CCP to the transferee the legal or beneficial interest of the CCP in the property held on trust, and any powers, rights or obligations of the CCP in respect of the property held on trust.

7.10 Regulation 7 (additional restrictions on reverse transfers) provides for additional limits to apply where there is a partial property transfer under paragraphs 70 or 72 (reverse property transfer) of Schedule 11. Reverse property transfers are, broadly, transfers of shares or property back to the original transferor under the original instrument from the transferee. As per paragraph 72(4) of Schedule 11, the transferee in this case will be the Bank, a company wholly owned by the Bank or the Treasury or a nominee of the Treasury. These protections limit what property may (or may not) be transferred by way of reverse property transfer where regulation 7 applies to a partial property transfer.

7.11 Regulation 8 (CCP group companies) restricts partial property transfers in respect of the property, rights or liabilities of a relevant company (defined in regulation 8(3)). Any such transfers may only be made where they are necessary for carrying on the business, or any part of the business, of the CCP which is (or, but for the exercise of a stabilisation power, would be) in the same group as the relevant company.

7.12 Chapter 2 of Part 2 (containing Regulations 9, 10 and 11) provides for the relevant remedy where a partial property transfer has been made in contravention of the relevant safeguards set out in Part 2 of these Regulations. Regulation 9 (market contracts and continuity powers) sets out that where a partial property transfer is made in contravention of regulation 5 (financial markets) or any other regulation in Part 2 which relates to the exercise of the continuity powers, it is void so far as it was made in contravention of those Regulations. Regulation 10 (set-off and netting) provides that where the partial property transfer has been made in contravention of Regulation 3 (protected rights and liabilities) it does not affect the exercise of the right to set-off or net. Regulation 10 does not apply where the contravention relates to the exercise of the continuity powers, in which case regulation 9 (market contracts and continuity powers) applies instead. Regulation 11 (contravention of other provisions of Part 2) sets out the actions which any person who considers that a partial property transfer has been made in contravention of the provisions in Part 2 may take, the procedure by which the Bank is to be notified of such a contravention, and the remedial steps the

Bank must take if it agrees that such a contravention has taken place. Regulation 11 does not apply to the extent that Regulations 9 or 10 apply.

7.13 Part 3 of these Regulations imposes restrictions and safeguards on the making of write-down provisions under Schedule 11 (as defined in paragraph 34(2) of the Schedule). Broadly, this Part reflects the existing legislation in Banking Act 2009 (Restrictions of Special Bail-in Provision, etc) Order 2014, insofar as its provisions are relevant to CCPs, for the purposes of the CCP resolution regime. Regulation 12 sets out the application of the Part to an instrument which makes write down provision.

7.14 Regulation 13 (set-off and netting) provides that write-down instruments may not make write-down provision in respect of a protected liability. Protected liabilities are defined in Regulation 13(2). Broadly, these are CCP's liabilities which are subject to set-off or netting, and are not excluded from the definition of protected liabilities under regulation 13(3). Regulation 13 does not prevent write-down provision from being made to convert the protected liability into the net debt, claim or obligation that would due under set-off or netting arrangements. Regulation 14 provides definitions of certain key terms relating to set-off and netting for the purposes of Part 3 of these Regulations.

7.15 Regulations 15 and 16 provide for the remedy available, and the relevant periods (as defined in regulation 16) where any person considers that a write-down instrument to which Part 3 applies has been made in contravention of the provisions in Part 3, and sets out the process for: the giving of a notice to the Bank of the alleged contravention; the process by which the Bank is to assess any notice of contravention; and the Bank's options where it does not agree that there has been a contravention and the steps where the Bank agrees that there has been a contravention.

7.16 As set out above, Part 4 of these Regulations makes provision to revoke the Banking Act 2009 (Restriction of Partial Property Transfers) (Recognised Central Counterparties) Order 2014 (see regulation 17). Regulation 18 makes transitional provision in relation to this revocation, as set out in paragraph 6.5 above.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

9. Consolidation

9.1 This instrument is not amenable to consolidation.

10. Consultation outcome

10.1 A full consultation on the expanded resolution regime for CCPs was conducted. It ran from 24 February 2021 to 28 May 2021, and the government received 14 written responses, as well as running a number of engagement sessions.[1] Feedback from these sessions and responses was taken into account in developing the policy that underpins Schedule 11.

[1] https://www.gov.uk/government/consultations/expanded-resolution-regime-for-central-counterparties-ccp-consultation

10.2 As envisaged by paragraph 20 of Schedule 11 of FSMA 2023, the Treasury also consulted the Resolution Liaison Panel on the policy intent behind a number of Statutory Instruments it intended to lay, including these Regulations.

11. Guidance

11.1 There is no specific guidance for this SI. However, HM Treasury intends to publish a Code of Practice which provides wider guidance around the resolution regime.

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 de minimis Impact Assessment has been prepared for this instrument because of the potential costs associated with businesses familiarising themselves with these Regulations.

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 the monitoring of this legislation is that the government intends to monitor the legislation on an ongoing basis in light of emerging risks.

15. Contact

15.1 Edward Henley at HM Treasury (email: edward.henley@hmtreasury.gov.uk) can be contacted with any queries regarding the instrument.

15.2 George Barnes, Deputy Director for Banking Assets and Resolution Strategy at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.

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