EXPLANATORY MEMORANDUM TO

THE RESOLUTION OF CENTRAL COUNTERPARTIES (MODIFIED APPLICATION OF CORPORATE LAW AND CONSEQUENTIAL AMENDMENTS) 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 instrument amends corporate law, as defined in FSMA 2023, and makes the necessary consequential amendments to ensure that the central counterparty (CCP) resolution regime functions as intended.

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 Resolution of Central Counterparties (Modified Application of Corporate Law and Consequential Amendments) 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) (BA09) as applied to CCPs by sections 89B-89G of that Act.

6.2 Schedule 11 to FSMA 2023 (Schedule 11) introduced an expanded CCP resolution regime, replacing sections 89B-89G of BA09. This provides the Bank of England, 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 toolkit allows the Bank of England (the Bank) to allocate losses arising

from a failure to clearing members and the CCP itself, mitigating the loss falling to the taxpayer and aiming to prevent contagion across the financial sector.

6.3 Paragraph 165(1) of Schedule 11 provides HMT with a power to make regulations applying corporate law with modifications. "Corporate law" means the legislation listed in paragraph 165(2) of Schedule 11, including in particular the Companies Act 2006 (c. 46) and the Bank Recovery and Resolution (No.2) Order 2014 (S.I. 2014/3348).

6.4 The UK bank resolution regime contains similar provisions amending corporate law (see Part 17 of the Bank Recovery and Resolution (No.2) Order 2014 (modified application of company law to banks etc. in resolution) and Schedule 4 of that Order (modified application of the Companies Act 2006 to banks etc. in resolution)), and these Regulations make parallel provision so far as possible, and with necessary amendments for the CCP context.

6.5 Section 83 of FSMA 2023 allows HMT to make regulations containing necessary consequential amendments further to the commencement of Schedule 11.

7. Policy background

What is being done and why?

7.1 This legislation makes the necessary corporate law modifications and consequential amendments to ensure that the CCP resolution regime (under Schedule 11) will function effectively. These Regulations apply certain provisions from the Companies Act 2006 (the 2006 Act) and related legislation with modifications, and make consequential amendments to primary and secondary legislation in relation to the implementation of Schedule 11.

7.2 Broadly, the following changes firstly ensure parity with the modifications to certain aspects of company law which apply to the bank resolution regime as set out in Part 17 of, and Schedule 4 to, the Bank Recovery and Resolution (No.2) Order 2014. Secondly, they make consequential amendments more broadly to ensure that the consequences for CCPs of the use of resolution powers under Schedule 11 are consistent with the consequences that would arise under the resolution regime in BA09, and that necessary amendments are made to ensure that the Bank can use Schedule 11 powers in a similar way to its powers under the existing regime (for example, in respect of the disclosure (by or to the Bank) of confidential information for resolution purposes).

7.3 Part 2 of these Regulations applies certain provisions of the 2006 Act with modifications for the purposes of the CCP resolution regime. Regulation 3 (modified application of the Companies Act 2006 (disapplication of takeover rules)) modifies Part 28 of the 2006 Act so that it requires rules made under paragraph 7(1) and (2) of Part 2 of Schedule 1C to the 2006 Act (rules of the takeover panel: general principles) to specify that they do not apply to share transfers or other transactions effected by a resolution action. This will ensure that a resolution is not subject to obligations which will delay the resolution action.

7.4 Regulation 4 (modified application of the Companies Act 2006 (shareholders' rights)) is based on Article 220A of the Bank Recovery and Resolution (No. 2) Order 2014. It applies the provisions in the Companies Act 2006 which relate to shareholders' rights to call general meetings and to amend the articles of association of the company with the modification necessary for the purposes of Schedule 11. In particular, Regulation

4(5) modifies the 2006 Act so that it reads as if a new provision were inserted relating to the rights of shareholders in relation to proposals to increase the share capital of a company to which Schedule 11 applies if certain conditions are met.

7.5 Regulation 5 (modified application of the Companies Act 2006 (application of the Bank Recovery and Resolution (No. 2) Order 2014)) applies the modifications made to the Companies Act 2006 in Schedule 4 to the 2014 Order (modified application of the Companies Act 2006 to banks etc in resolution) with certain further modifications in order to ensure the provisions in Schedule 4 function appropriately for the CCP resolution regime. Specifically, the changes made mean that, for the purposes of Schedule 11, references in the modifications made by Schedule 4 to the 2014 Order to "companies under resolution" and the term "resolution tools, powers and mechanisms" will be read as they are defined in Regulation 2 of these Regulations.

7.6 Regulation 6 (modified application of the Companies Act 2006 (Commencement No. 8, Transitional Provisions and Savings) Order 2008) applies the Companies Act 2006 (Commencement No. 8, Transitional Provisions and Savings) Order 2008 (S.I. 2008/2860) with modifications for the purposes of Schedule 11. The modification made by Regulation 6 has the effect that the transitional provision in paragraph 43 of Schedule 2 to the 2008 Order is disapplied in relation to a company which is an existing company or a transitional company (within the meaning of the 2006 Act) for the purposes of Schedule 11. The modification made by Regulation 6 is based on the equivalent modification made in relation to banks in resolution under article 220 of the Bank Recovery and Resolution (No. 2) Order 2014.

7.7 Part 3 of these Regulations (consequential amendments) makes consequential amendments to primary and secondary legislation relating to Schedule 11 to ensure the CCP resolution regime functions as intended and consistently with the BA09 resolution regime.

7.8 Regulation 7 (amendments to the Finance Act 1986) concerns the application of stamp duty to involuntary transfers made under Schedule 11, by inserting new provisions into Section 85A of the Finance Act 1986 (c. 41). Section 85A provides that stamp duty is not chargeable in relation to instruments listed under Section 85A(2). This amendment ensures that equivalent instruments made under Schedule 11 are also included in the exemption, ensuring that stamp duty is not charged on involuntary transfers and avoiding any potential hindrances to a resolution being conducted effectively. This ensures parity with instruments already listed which may be made in the context of the resolution of a CCP under the BA09 regime, and ensures that third-country instruments made in relation to CCPs under Schedule 11 are treated in the same way as third-country instruments made in respect of banks under BA09 for these purposes (third-country instruments cannot be made in relation to CCPs under the BA09 regime).

7.9 Regulation 8 (amendments to the Companies Act 1989) amends Section 87(2) (exceptions from restrictions on disclosure) and Section 166 (powers to give directions) of the Companies Act 1989 (c. 40). The amendment to Section 87 allows information which is subject to disclosure restrictions under Section 86 (restrictions on disclosure of information) to be disclosed for the purpose of civil proceedings in relation to an assessment of compensation under the provisions of Schedule 11. Compensation might be payable under Schedule 11 to creditors of a CCP, should they be left worse off in resolution than they would have if the CCP had entered regular insolvency proceedings. The amendment to Section 166 (powers to give directions)

adds to the conditions which must be met before an appropriate regulator can make a direction. The amendment ensures that the conditions include circumstances where the direction is necessary to facilitate the use of a power under Schedule 11, or in connection with the use of such a power. Both amendments ensure consistency with resolution under the BA09 regime.

7.10 Regulation 9 (amendments to the Bank of England Act 1998) amends sections 7A and 9O of the Bank of England Act 1998 (c. 11). Section 7A of that Act (accounts of companies wholly owned by the Bank) gives the Bank the power to make a direction to a "qualifying company", exempting them from certain requirements under that Act. The amendment made by Regulation 9 excludes a company which is a bridge central counterparty for the purpose of paragraph 29 of Schedule 11 (bridge central counterparty) from the definition of a "qualifying company". Paragraph 29 of Schedule 11 allows the Bank to transfer all or part of the business of a failing CCP into a separate company (owned and controlled by the Bank) for the purpose of maintaining access to critical clearing services, and (in due course) selling the CCP or its business. Section 9O of the Bank of England Act 1998 (making of recommendations within the Bank) provides that the Financial Policy Committee may not make recommendations about the exercise by the Bank of its powers under the bank resolution regime in BA09. The amendment made to Section 9O ensures the same exemption from recommendations applies to the CCP resolution regime.

7.11 Regulation 10 (amendments to the Financial Services and Markets Act 2000) amends paragraph 34(7) of Part 3 of Schedule 17A to the Financial Services and Markets Act 2000 (c. 8) (further provision in relation to exercise of Part 18 functions, or other FMI functions). The amendment relates to the winding up, administration or insolvency of recognised clearing houses (also referred to as CCPs), and replaces a reference to the intended use of a stabilisation power under the BA09 regime with a reference to the intended use of such a power under Schedule 11.

7.12 Regulation 11 (amendments to the Finance Act 2003) concerns Stamp Duty Land Tax. It amends Section 66A(2) of the Finance Act 2003 (c. 14) (resolution of financial institutions). Section 66A provides that certain transactions are exempt from Stamp Duty Land Tax, and lists several transactions effected by instruments made under the BA09 resolution regime. The amendment made by Regulation 11 includes similar instruments made in the context of the resolution of a CCP under Schedule 11 within this list.

7.13 Regulation 12 (amendment to the Corporation Tax Act 2009) ensures consistency with the approach taken for the BA09 resolution regime, by amending Section 322(5A) of the Corporation Tax Act 2009 (c. 4) (release of debts: cases where credits not required to be brought into account). Section 322(5A) specifies that cases where a credit arises in a debt relationship (within the meaning of that section) as a result of the operation of a stabilisation power under the BA09 do not have to be brought into account for the purposes of the calculation of corporation tax. The amendment made by Regulation 12 makes equivalent provision in respect of the operation of stabilisation powers under the CCP resolution regime.

7.14 Regulation 13 (amendment to the Taxation (International and Other Provisions) Act 2010) amends Section 259NEC of the Taxation (International and Other Provisions) Act 2010 (c. 8) (release of debts). Section 259NEC sets out the circumstances which apply for the purposes of Section 259NEB (relevant debt relief circumstances) and includes circumstances where the release is in consequence of the making of certain

instruments in a resolution under the BA09 resolution regime. The amendment made by Regulation 13 extends these circumstances to include releases in consequence of the exercise of a stabilisation power under Schedule 11, ensuring parity with the BA09 resolution regime.

7.15 Regulation 14 (amendment to the Financial Services Act 2012) again ensures parity with the BA09 resolution regime, by amending Section 60(5)(b) of the Financial Services Act 2012 (c. 12), which sets out the circumstances in which the Treasury's power of direction under Section 61 is exercisable. This power of direction provides that, where the relevant circumstances are met, the Treasury can give a direction to the Bank relating to the issues listed in Section 61(2), including (in Section 61(2)(b)) the exercise by the Bank of any stabilisation power under the resolution regimes in the BA09 or Schedule 11; the reference to Schedule 11 was inserted by paragraph 163(4) of Schedule 11. The circumstances which give rise to the power of direction include where the Treasury has incurred expenditure in connection with the exercise of any powers under Parts 1 to 3 of BA09. The amendment made by Regulation 14 amends this to include expenditure incurred in relation to the exercise of powers under Schedule 11 within this provision, building on the amendment made by Schedule 11.

7.16 Regulation 15 makes amendments to the Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Regulations 2001 (S.I. 2001/2188) (the 2001 Regulations). The 2001 Regulations specify the circumstances in which confidential information, within the meaning of the Financial Services and Markets Act 2000, can be disclosed. Section 348(2) of the 2000 Act (restrictions on disclosure) defines confidential information as information which relates to the business or other affairs of any person and which was received by the primary recipient for the purposes of, or in the discharge of, the functions of the Financial Conduct Authority, the Prudential Regulation Authority or the Secretary of State under the 2000 Act, and which is not prevented from being confidential under Section 348(4) of the 2000 Act. The 2001 Regulations currently make provision relating to the disclosure (by and to the Bank, the Financial Conduct Authority and the Prudential Regulation Authority ("the relevant authorities") among others of "recovery and resolution information" received under the BA09 resolution regime. In summary, the 2001 Disclosure Regulations set out the circumstances in which recovery and resolution information can be disclosed for the purposes of the relevant authorities' functions under the BA09. The amendments made by Regulation 16 modify the definition of "recovery and resolution information" to include confidential information received by the relevant authorities in the course of discharging functions under the Schedule 11. Regulation 15 also makes other amendments, such as amendments to defined terms, to ensure that the 2001 Regulations apply to the special resolution regime under Schedule 11 in the same way as they apply to the BA09 resolution regime.

7.17 Regulation 16 (amendments to the Financial Collateral Arrangements (No. 2) Regulations 2003) amends regulations 3(1A) 12(5) and 18A(1) of the Financial Collateral Arrangements (No. 2) Regulations 2003 (S.I. 2003/3226). The amendment to Regulation 3(1A) (interpretation) excludes the Bank's use of resolution powers under Schedule 11 from the definition of an "enforcement event" within the 2003 Regulations. The amendment to Regulation 12(5) (close-out netting provisions to take effect in accordance with their terms) provides that nothing in that Regulation prevents the Bank of England imposing a restriction on the effect of a close out netting provision in the exercise of its powers under the CCP resolution regime in Schedule 11. The amendment to Regulation 18A (restrictions on enforcement of

financial collateral arrangements) provides that regulations 16 and 17 of the 2003 Regulations (right of use and appropriation of financial collateral under a security financial collateral arrangement) do not prevent the Bank from imposing restrictions on the enforcement of financial collateral arrangements, or on the effect of a security financial collateral arrangement, close-out netting provision or set-off arrangement, in the exercise of its powers under Schedule 11.

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.

10.2 As envisaged by paragraph 20 of Schedule 11, the Treasury also consulted the 'CCP 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 CCP 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 full Impact Assessment has not been prepared for this instrument because no significant impacts were identified. 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 to activities that are undertaken by small businesses.

14. Monitoring & review

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

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

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