EXPLANATORY MEMORANDUM TO

THE TRANSPARENCY OF SECURITIES FINANCING TRANSACTIONS AND OF REUSE (AMENDMENT) (EU EXIT) REGULATIONS 2019

2019 No. 542

1. Introduction

1.1 This explanatory memorandum has been prepared by Her Majesty's Treasury and is laid before Parliament by Act.

2. Purpose of the instrument

2.1 This instrument is being made to address deficiencies in retained EU law in relation to Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 (known as the securities financing transactions regulation, or SFTR), as well as the Financial Services and Markets Act 2000 (Transparency of Securities Financing Transactions and of Reuse) Regulations 2016 (SI: 2016/715), which arise from the withdrawal of the United Kingdom (UK) from the European Union (EU), ensuring the legislation continues to operate effectively at the point at which the UK leaves the EU.

Explanations

What did any relevant EU law do before exit day?

2.2 Securities Financing Transactions (SFTs) are any transactions where securities (a tradable financial asset, such as equities) are used to borrow cash, or vice versa. An example of these are repurchase agreements (commonly known as 'repos') which are used within financial services firms as a means of borrowing/loaning cash generally over short-term periods. Other examples include securities lending activities and sell/buy-back transactions.

2.3 SFT markets were not regulated by other legislation before 2015 and there were concerns that SFTs can contribute to pro-cyclicality in financial markets (i.e. amplifying rises/falls in the market), as well as contributing to the build-up of leverage and interconnectedness within markets. In response to this, the Financial Stability Board (FSB) issued recommendations to address the potential risks posed by SFTs.

2.4 The SFTR is the EU's response to the recommendations made by the FSB. The SFTR aims to manage risks posed by SFTs by creating a framework under which details of transactions must be reported to trade repositories. This information must then be disclosed to investors, and national regulators are required to act in cases where firms are deemed to be engaging in risky practices.

2.5 The SFTR increases the transparency of SFTs by requiring all SFTs, except those concluded with central banks, to be reported to central databases known as trade repositories (TRs). Furthermore, SFTR requires information on the use of SFTs by investment funds to be disclosed to investors in regular reports and pre-investment documents issued by the funds.

2.6 SFTR also sets minimum transparency conditions to be met when collateral is reused (i.e. when assets are delivered as collateral in a transaction by an intermediary or collateral taker), such as disclosure of the risks and the obligation to acquire prior consent. Collateral reuse refers to instances where the same piece of collateral is used multiple times as part of a transaction chain, which can risk a lack of clarity over what aspect of a transaction specific collateral is being held against.

Why is it being changed?

2.7 SFTR is directly applicable EU law. Once the UK leaves the EU, SFTR will cease to apply in the UK, but by the operation of the European Union (Withdrawal) Act 2018 (EUWA), SFTR will become part of the UK statute book as direct retained EU law. For SFTR to continue to remain operable in the UK post-exit, several deficiencies in the existing text need to be corrected. The Financial Services and Markets Act 2000 (Transparency of Securities Financing Transactions and of Reuse) Regulations 2016 were made under powers in the European Communities Act 1972, and is therefore EU-derived legislation. It also contains deficiencies that will arise because of the UK leaving the EU. For example, certain responsibilities under the SFTR currently sit with EU institutions and will need to be transferred to appropriate UK bodies. If these deficiencies are not addressed, then significant aspects of the UK market for SFTs will be unregulated after the UK leaves the EU. This would leave the UK in a position where it was failing to meet the recommendations of the FSB. Given the impact of SFTs on the wider financial system, it would also increase risk in the financial markets and could therefore undermine financial stability.

What will it now do?

2.8 This SI makes amendments to ensure that the UK's regulation of SFTs can operate effectively at the point at which the UK leaves the EU. These include:

- Changes to the treatment of EEA branches of financial services firms in the UK, so that after exit, EEA branches operating in the UK must report their transactions to a UK trade repository. This will bring treatment of EEA branches into line with the current treatment of other third country branches in the UK.
- Amending the list of entities that have the right to access SFT data reported to trade repositories. EU bodies are removed, and the list is made UK-specific to reflect the UK's position outside the EU.
- Responsibilities under SFTR that currently sit with EU institutions are transferred to the appropriate UK equivalent.

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 The territorial application of this instrument includes Scotland and Northern Ireland.

3.3 The powers under which this instrument is made cover the entire United Kingdom (see section 8(1) of, and paragraph 21 of Schedule 7 to the EUWA) and the territorial application of this instrument is not limited either by the Act or by the instrument.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is to the whole of the United Kingdom.

4.2 The territorial application of this instrument is to the whole of the United Kingdom.

5. European Convention on Human Rights

5.1 The Economic Secretary to the Treasury (John Glen MP) has made the following statement regarding Human Rights:

"In my view the provisions of the Transparency of Securities Financing Transactions and of Reuse (Amendment) (EU Exit) Regulations 2019 are compatible with the Convention rights".

6. Legislative Context

6.1 This SI amends SFTR, as SFTR will form part of domestic law by virtue of s.3 of the EUWA. It also amends the Financial Services and Markets Act 2000 (Transparency of Securities Financing Transactions and of Reuse) Regulations 2016. These amendments are made to address failures of the retained EU law to operate effectively, and other deficiencies arising from the withdrawal of the UK from the EU.

7. Policy background

What is being done and why?

7.1 The UK will leave the EU on 29 March 2019. The UK and the EU have agreed the terms of an implementation period that will start on 29 March 2019 and last until 31 December 2020. Therefore, should a deal be approved, the implementation period will provide time to introduce the new arrangements that will underpin the future UK-EU relationship, and provide valuable certainty for businesses and individuals. During an implementation period, common rules will continue to apply. The UK would continue to implement new EU law that comes into effect and the UK would continue to be treated as part of the EU's single market in financial services. This would mean that access to each other's markets will continue on current terms and businesses, including financial services firms, will be able to trade on the same terms as now until 31 December 2020. UK firms will need to comply with any new EU legislation that becomes applicable during the implementation period.

7.2 The government is seeking a deep and special future partnership with the EU, which should be greater in scope and ambition than any such agreement before and encompass financial services. Given the highly regulated nature of financial services, the volume of trade between UK and EU markets, and a shared desire to manage financial stability risks, the UK proposes a new economic and regulatory arrangement that will preserve mutually beneficial cross-border business models and economic integration for the benefit of businesses and consumers. Decisions on market access would be autonomous in our proposed model, but would be underpinned by stable institutional processes in a bilateral agreement and continued close regulatory and supervisory cooperation.

7.3 While the government believes that there will be a deal and an implementation period in place, it must plan for all eventualities, including a 'no deal' scenario. HM Treasury intends to use powers in the EUWA to ensure that the UK continues to have a functioning financial services regulatory regime in all scenarios.

7.4 The EUWA repeals the European Communities Act 1972 and converts into UK domestic law the existing body of directly applicable EU law (including EU Regulations). It also preserves UK laws relating to EU membership – e.g. legislation implementing EU Directives. This body of law is referred to as "retained EU law". The EUWA also gives ministers a power to prevent, remedy or mitigate any failure of EU law to operate effectively, or any other deficiency in retained EU law, through SIs. These contingency preparations for financial services legislation are sometimes referred to as 'onshoring'. The powers in the EUWA are not intended to make policy changes, other than to reflect the UK's new position outside the EU, and to smooth the transition to this situation. The scope of the power is drafted to reflect this purpose and is subject to further restrictions, such as the inability to use the power to impose or increase taxation, or establish a public authority. The power is also time-limited and falls away two years after exit day.

7.5 Wherever practicable, the proposed approach is that the same laws and rules that are currently in place in the UK would continue to apply at the point of exit, providing continuity and certainty as we leave the EU. However, if the UK does not enter an implementation period, some changes would be required to reflect the UK's new position outside the EU from 29 March 2019.

7.6 If the UK were to leave the EU without a deal, the UK would be outside the EU's framework for financial services. The UK's position in relation to the EU would be determined by the default Member State and EU rules that apply to third countries at the relevant time. The European Commission has confirmed that this would be the case.

7.7 In light of this, the approach in this scenario cannot and does not rely on any new, specific arrangements being in place between the UK and the EU. As a general principle, the UK would also need to default to treating EU Member States largely as it does other third countries, although there are cases where a different approach would be needed including to provide for a smooth transition to the new circumstances.

7.8 HM Treasury published a document on 27 June 2018, which sets out in more detail HM Treasury's approach to financial services legislation under the EUWA. (https://www.gov.uk/government/publications/financial-services-legislation-under-the-eu-withdrawal-act)

7.9 This SI makes amendments to aspects of SFTR to ensure that it continues to operate effectively in the UK once the UK has left the EU. These changes include:

The treatment of branches

7.10 SFTR's reporting mechanism currently allows EU firms to consolidate their reporting to a single trade repository based in the EU. This simplifies the reporting process for firms, who then only have to submit one report across the EU28.

7.11 Once the UK leaves the EU, this consolidated reporting system will end and the existing third country requirement for reporting SFTs will be extended to EU27 branches. Therefore, SFTs with a UK party will need to be reported both to a UK

trade repository and, if an EU27 party is also involved, to the EU27 trade repository. For example, an SFT involving a UK branch of an EU27 firm, as well as branches based in the EU27, will have to be reported both to a UK trade repository and an EU27 trade repository. UK firms with EEA branches will have to report SFTs to a UK trade repository and, if an EU27 branch is also involved in the transaction, to the appropriate EU27 trade repository too.

7.12 This instrument therefore enacts this change in the reporting process. While this would create a dual reporting burden on firms operating in both the EU27 and UK, evidence indicates that this additional burden is not expected to be significant, as firms would be reporting the same data on the same templates, but to two separate trade repositories.

Right to access trade repository data

7.13 Article 12(2) of the SFTR contains an exhaustive list of EU entities that have the right to access trade repository data.

7.14 This instrument amends that list to remove EU27 entities that will no longer have jurisdiction in the UK post-exit. The EU SFTR already specifies that the relevant competent authority and supervisory authorities designated under Article 4 of Directive 2004/25/EC are entitled to access, but to clarify this instrument specifies these bodies are the Prudential Regulation Authority (PRA), the Pensions Regulator, the Bank of England and the Panel on Takeovers and Mergers.

7.15 To allow for future reciprocal data access agreements to be made between the UK and third countries, the power to specify which third country entities can access data on SFTs held in trade repositories established in the UK will be transferred from the European Commission to HM Treasury. Transferring this power is necessary to ensure the continued functioning of SFTR post-exit because it will ensure that the UK is enabled to maintain an up to date list of entities that are entitled to access UK-held data on SFTs. The power envisaged does not currently exist in the Financial Services and Markets Act 2000 (FSMA), therefore this instrument inserts a bespoke power into the retained UK version of SFTR.

7.16 Article 4(1) reporting requirements: Article 4(1) of the SFTR sets out the primary reporting obligations for firms to ensure that the overall legislation can be effectively applied. While Article 4(1) is in force, it becomes applicable to different firms/entities over a staggered period, between 12 and 21 months from the date that the EU publishes the Regulatory Technical Standards (RTS) associated with the Article (with the European Commission responsible for specifying precisely when they become applicable). The EU are yet to publish this RTS, meaning that Article 4(1) will not become applicable before March 2019 (given the minimum 12-month implementation after publication of the RTS). The EUWA provides the power to onshore EU legislation that is both ‘in force’ and ‘applicable’ on Exit Day – meaning Article 4(1) will not be transferred onto the UK statute book by the EUWA.

7.17 Binding Technical Standards and other transfers of function: This instrument transfers functions to the PRA and Financial Conduct Authority (FCA) that are currently attributed to EU bodies. Reporting responsibilities previously overseen by the European Securities and Markets Authority, for example if a trade repository is not available to record details of SFTs, is transferred to the FCA. The power to draft regulatory technical standards are transferred to the PRA and FCA. The power to withdraw the registration of a trade repository, on certain conditions, is transferred to

the FCA. The FCA is also required to publish a list of trade repositories registered in accordance with Article 7 SFTR.

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

8.1 This instrument is being made using the power in section 8 of, and paragraph 21 of Schedule 7 to, the EUWA to address failures of retained EU law to operate effectively or other deficiencies arising from the withdrawal of the United Kingdom from the European Union. In accordance with the requirements of that Act the Minister has made the relevant statements as detailed in Part 2 of the Annex to this Explanatory Memorandum.

9. Consolidation

9.1 There are currently no plans to consolidate the relevant legislation.

10. Consultation outcome

10.1 HM Treasury has not undertaken a consultation on the instrument, but has engaged with relevant stakeholders on its approach to Financial Services legislation under the EUWA, including on this instrument, in order familiarise them with the legislation ahead of laying.

10.2 This instrument was also published in draft, along with an explanatory policy note, on 19 December 2018, to maximise transparency ahead of laying (https://www.gov.uk/government/publications/draft-transparency-of-securities-financing-transactions-and-of-reuse-amendment-eu-exit-regulations-2019).

10.3 The PRA and the FCA are undertaking public consultation on any changes they propose to make to Binding Technical Standards and rules made under the powers conferred upon them by FSMA. These consultations can be found at:

https://www.bankofengland.co.uk/paper/2018/the-boes-approach-to-amending-financial-services-legislation-under-the-eu-withdrawal-act-2018

https://www.fca.org.uk/publications/consultation-papers/cp18-28-brexit-proposed-changes-handbook-bts-first-consultation

11. Guidance

11.1 No further guidance is being published alongside this instrument.

12. Impact

12.1 The impact on businesses of this instrument is limited. As noted above, there may be an extra burden placed on firms to report SFTs to both a UK and EU27 trade repository, but our assessment is that the impact of this will be minimal. This is because firms will be reporting the same SFTs, but to two trade repositories rather than one, with the same information requirements for each repository. There will be a cost to familiarisation with the text of the SI, however this is expected to be a one-off cost for firms.

12.2 There is no material impact on charities or voluntary bodies.

12.3 In the public sector the FCA and PRA will be responsible for carrying out functions under SFTR, as detailed above, that are currently carried out by the European

Supervisory Authorities. HM Treasury has been working closely with the FCA and PRA to ensure that they are well prepared for taking on these additional functions.

12.4 A full Impact Assessment will be published alongside this Explanatory Memorandum on the legislation.gov.uk website, when an opinion from the Regulatory Policy Committee has been received.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses where they engage in the trade of SFTs.

13.2 This instrument addresses deficiencies in the legislation that will exist after the UK leaves the EU, and therefore aims to minimise the impact of these regulatory changes on all firms, including small businesses.

14. Monitoring & review

14.1 As this instrument is made under the EUWA, no review clause is required.

15. Contact

15.1 Luke Miller at HM Treasury Telephone: 02072704399 or email: Luke.Miller@hmtreasury.gov.uk or Pawel Wargan at HM Treasury Telephone: 02072706167 or email: Pawel.Wargan@hmtreasury.gov.uk can be contacted with any queries regarding the instrument.

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

15.3 The Economic Secretary to the Treasury John Glen can confirm that this Explanatory Memorandum meets the required standard.

Annex

Statements under the European Union (Withdrawal) Act 2018

Part 1

Table of Statements under the 2018 Act

This table sets out the statements that may be required under the 2018 Act.

Statement	Where the requirement sits	To whom it applies	What it requires
Sifting	Paragraphs 3(3), 3(7) and 17(3) and 17(7) of Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) to make a Negative SI	Explain why the instrument should be subject to the negative procedure and, if applicable, why they disagree with the recommendation(s) of the SLSC/Sifting Committees
Appropriate-ness	Sub-paragraph (2) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2	A statement that the SI does no more than is appropriate.
Good Reasons	Sub-paragraph (3) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2	Explain the good reasons for making the instrument and that what is being done is a reasonable course of action.
Equalities	Sub-paragraphs (4) and (5) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2	Explain what, if any, amendment, repeals or revocations are being made to the Equalities Acts 2006 and 2010 and legislation made under them. State that the Minister has had due regard to the need to eliminate discrimination and other conduct prohibited under the Equality Act 2010.
Explanations	Sub-paragraph (6) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2 In addition to the statutory obligation the Government has made a political commitment to include these statements alongside all EUWA SIs	Explain the instrument, identify the relevant law before exit day, explain the instrument's effect on retained EU law and give information about the purpose of the instrument, e.g., whether minor or technical changes only are intended to the EU retained law.
Criminal offences	Sub-paragraphs (3) and (7) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9, and	Set out the 'good reasons' for creating a criminal offence, and the penalty attached.

		23(1) or jointly exercising powers in Schedule 2 to create a criminal offence	
Sub-delegation	Paragraph 30, Schedule 7	Ministers of the Crown exercising sections 10(1), 12 and part 1 of Schedule 4 to create a legislative power exercisable not by a Minister of the Crown or a Devolved Authority by Statutory Instrument.	State why it is appropriate to create such a sub-delegated power.
Urgency	Paragraph 34, Schedule 7	Ministers of the Crown using the urgent procedure in paragraphs 4 or 14, Schedule 7.	Statement of the reasons for the Minister's opinion that the SI is urgent.
Explanations where amending regulations under 2(2) ECA 1972	Paragraph 13, Schedule 8	Anybody making an SI after exit day under powers outside the European Union (Withdrawal) Act 2018 which modifies subordinate legislation made under s. 2(2) ECA	Statement explaining the good reasons for modifying the instrument made under s. 2(2) ECA, identifying the relevant law before exit day, and explaining the instrument's effect on retained EU law.
Scrutiny statement where amending regulations under 2(2) ECA 1972	Paragraph 16, Schedule 8	Anybody making an SI after exit day under powers outside the European Union (Withdrawal) Act 2018 which modifies subordinate legislation made under s. 2(2) ECA	Statement setting out: a) the steps which the relevant authority has taken to make the draft instrument published in accordance with paragraph 16(2), Schedule 8 available to each House of Parliament, b) containing information about the relevant authority's response to— (i) any recommendations made by a committee of either House of Parliament about the published draft instrument, and (ii) any other representations made to the relevant authority about the published draft instrument, and, c) containing any other information that the relevant authority considers appropriate in relation to the scrutiny of the instrument or draft instrument which is to be laid.

Part 2

Statements required when using enabling powers under the European Union (Withdrawal) 2018 Act

1. Appropriateness statement

1.1 The Economic Secretary to the Treasury John Glen MP has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

"In my view the Transparency of Securities Financing Transactions and of Reuse (Amendment) (EU Exit) Regulations 2019 does no more than is appropriate".

1.2 This is the case because it is in line with the European Union (Withdrawal) Act 2018 in serving to make those changes necessary to provide a functioning statute book in relation to the continued regulation of SFTs on the day we leave the EU.

2. Good reasons

2.1 The Economic Secretary to the Treasury John Glen MP has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

"In my view there are good reasons for the provisions in this instrument, and I have concluded they are a reasonable course of action".

2.2 These are: if this Government were not to proceed with this legislation, then the regulation of SFTs within the UK would become legally inoperable. An unregulated SFT market could pose significant financial risk to the UK and wider financial market, therefore maintenance of the current standards is critical for providing certainty to the markets.

3. Equalities

3.1 The Economic Secretary to the Treasury John Glen MP has made the following statement:

"The instrument does not amend, repeal or revoke a provision or provisions in the Equality Act 2006 or the Equality Act 2010 or subordinate legislation made under those Acts".

3.2 The Economic Secretary to the Treasury John Glen MP has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

"In relation to the instrument, I, John Glen MP have had due regard to the need to eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Equality Act 2010."

4. Explanations

4.1 The explanations statement has been made in section 2 of the main body of this explanatory memorandum.

5. Legislative sub-delegation

5.1 The Economic Secretary to the Treasury, John Glen MP, has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

"In my view it is appropriate to create a relevant sub-delegated power in Transparency of Securities Financing Transactions and of Reuse (Amendment) (EU Exit) Regulations 2019.

5.2 This is appropriate because: The relevant regulator (either the FCA or the PRA, or in some cases both) will have the necessary technical knowledge and resource to ensure that the EU technical standards and reporting requirements which are relevant to the SFTR continue to operate effectively after the UK's exit from the EU. The required corrections and amendments to these binding technical standards will be of a highly technical nature, as will the oversight of reporting requirements, and the regulators will be best placed to assess these post-exit. The transfer of functions for binding technical standards to the regulators is also consistent with the general onshoring approach to such standards (as per the Financial Regulators' Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018 (S.I. 2018/1115))."