EXPLANATORY MEMORANDUM TO

THE CENTRAL SECURITIES DEPOSITORIES (AMENDMENT) (EU EXIT) REGULATIONS 2018

2018 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Act.

2. Purpose of the instrument

2.1 Central Securities Depositories (CSDs) are financial market infrastructures which keep a record of who owns individual securities, such as shares or bonds. They facilitate the transfer of securities between people and companies by registering a change of ownership after a trade is agreed ('settlement'). CSDs also provide for the initial recording of new securities.

2.2 This instrument amends Regulation (EU) No. 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No. 236/2012 ("the CSDR"), as well as the UK regulations that gave it effect in the UK.

2.3 The CSDR was given effect in the UK in stages via two sets of regulations. The Central Securities Depositories Regulations 2014, SI No. 2014/2879 ("the 2014 Regulations") came into force on 21st November 2014. The Central Securities Depositories (Amendment) Regulations 2017, SI No. 2017/1064 ("the 2017 Regulations") came into force on 28 November 2017.

2.4 To ensure the UK retains an operative regulatory framework for CSDs post exit, this SI does the following in relation to the CSDR:

- Makes technical changes to ensure that the UK retains an operative regulatory framework for CSDs in the event of a no deal scenario;
- Transfers the power to make equivalence decisions from the Commission to HM Treasury;
- Transfers powers from the European Securities and Markets Authority ("ESMA") to the Bank of England enabling the Bank of England to recognise third country CSDs post exit; and
- Provides a transitional regime so that third country CSDs[1] can continue to provide services to UK firms after exit.

[1] The instrument makes a change to the definition of third country CSD. In broad terms, before exit, "third country CSD" meant any CSD established outside the EU, whereas post-exit it will now mean any CSD established outside the UK.

Explanations

What did any relevant EU law do before exit day?

2.5 The CSDR created a common authorisation, supervision and regulatory framework for CSDs across the EU. The CSDR harmonises the timing and conduct of securities settlement in the EU and the rules governing the authorisation and operation of CSDs.

Why is it being changed?

2.6 The instrument addresses deficiencies in retained EU law that arise from the UK leaving the EU. It forms part of HM Treasury's contingency planning for a no deal scenario, making the necessary changes to ensure the UK continues to have a functioning financial services regime from exit day, regardless of the outcome of negotiations. We will be laying this legislation as a contingency.

What will it now do?

2.7 The instrument makes amendments to ensure the CSDR operates effectively after the UK withdraws from the EU. These amendments include: transferring the equivalence and recognition functions to relevant UK authorities; technical changes to the CSDR to ensure that the UK retains an operative regulatory framework for CSDs; and a transitional regime so that third country CSDs can continue to provide services relating to the UK after exit. The instrument also means an existing criminal offence will become relevant to third country CSDs after exit. More detail on the specific changes being made in these areas can be found in Section 7.

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 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 United Kingdom.

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

5. European Convention on Human Rights

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

"In my view the provisions of the Central Securities Depositories (Amendment) (EU Exit) Regulations 2018 are compatible with the Convention rights."

6. Legislative Context

6.1 The CSDR created a common authorisation, supervision and regulatory framework for CSDs at EU level. They harmonised the timing and conduct of securities settlement in the EU and the rules governing the authorisation and operation of CSDs.

6.2 The CSDR is coming into effect in stages and, therefore, domestic implementation has been staggered. The first stage was the 2014 Regulations, which designated the Bank of England, the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) as competent authorities in relation to different provisions in the CSDR and provided those bodies with powers for the enforcement of the CSDR and for sanctions which apply to the majority of market actors in scope.

6.3 The 2017 Regulations made additional competent authority designations, removed overlapping legislation, provided the Bank of England and the FCA with additional enforcement powers and made consequential amendments.

6.4 In accordance with the CSDR implementation and EU transitional provisions, most provisions of the CSDR only have effect once CSDs are authorised, and the EU delegated legislation allowing that authorisation process to start came into force on 30 March 2017.

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. This will provide time to introduce the new arrangements that will underpin the UK-EU future relationship, and provide valuable certainty for businesses and individuals. During the implementation period, common rules will continue to apply. The UK will continue to implement new EU law that comes into effect and the UK will continue to be treated as part of the EU's single market in financial services. This will 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 has every confidence that a deal will be reached and the implementation period will be in place, it has a duty to plan for all eventualities, including a 'no deal' scenario. The government is clear that this scenario is in neither the UK's nor the EU's interest, and the government does not anticipate it arising. To prepare for this unlikely eventuality, HM Treasury intends to use powers in the

European Union (Withdrawal) Act 2018 (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'. These SIs 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 In the unlikely scenario that the UK leaves 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 2018 Act. (https://www.gov.uk/government/publications/financial-services-legislation-under-the-eu-withdrawal-act)

Settlement discipline regime

7.9 Articles 6 to 8 of the CSDR relate to the settlement discipline regime. Articles 6 and 7 will not be in force before exit day. As a result, they cannot be considered retained EU law and are beyond the scope of the European Union (Withdrawal) Act 2018 ("the 2018 Act"). They will not become UK law on exit and, therefore, will not appear in the CSDR as given effect in the UK by this instrument after exit. Article 8 will be in force before exit day, but as it concerns the enforcement of Articles 6 and 7, it is not considered appropriate for inclusion in domestic law, and hence is being omitted by the instrument.

Transfer of functions

7.10 The instrument transfers various functions and powers currently held by ESMA to the appropriate UK authorities – the Bank of England, the FCA and the PRA. Powers are being transferred to the Bank of England for the purpose of recognising third country CSDs. The Commission's powers to make equivalence decisions are being transferred to HM Treasury (Article 25). Under Article 25, once an equivalence decision is made a third country CSD will be able to apply for recognition from the Bank of England. The FCA and the PRA will be responsible for drafting the regulatory technical standards to further specify details of the frameworks and tools for monitoring, measuring, management, reporting and public disclosure of credit and liquidity risks. In transferring these functions to UK regulators, HM Treasury has allocated the functions in a way that is consistent with the responsibilities already conferred on the Regulators by Parliament, thus providing certainty and continuity for firms.

Transitional provisions

7.11 The SI makes amendments to the transitional arrangements under Article 69 of the CSDR and related provisions in the 2017 Regulations. The transitional provisions, under the 2014 Regulations, allowed CSDs to apply for authorisation and third country CSDs to apply for recognition from ESMA. These amendments are intended to allow third country CSDs who wish to continue to provide services relating to the UK after exit to continue to benefit from transitional arrangements.

7.12 A requirement is introduced for third country CSDs to notify the Bank of England before exit day of their intention to provide services in the UK following exit. This requirement will also apply to any third country CSD benefiting at the point of exit from the transitional under the EU CSDR or the 2017 regulations. Third country CSDs within the transition will not be fully subject to the CSDR until their application for recognition has been determined or the time limit for such application has expired (six months from their jurisdiction being determined equivalent by HM Treasury). Any third country CSD who fails to notify the Bank of England may be subject to public censure, as set out in FSMA.

7.13 Further, existing UK CSDs that have made an application to the Bank of England for authorisation prior to exit will not be fully subject to the CSDR while that application is being considered.

7.14 The domestic legislation which was relevant to the regulation of CSDs prior to the CSDR can be found in Part 18 of FSMA. This sets out a regime under which entities such as CSDs and Central Counterparties are exempt from the FSMA general prohibition, provided they have been designated as "recognised clearing houses" by the FCA.

Criminal offences

7.15 This SI makes amendments to the scope of an existing criminal offence. This is because Regulation 5K(4) of the 2014 Regulations (an offence of providing false information to the Bank of England) will be relevant to third country CSDs after exit. Before exit this offence was only relevant to EU CSDs.

Consequential amendments

7.16 The SI makes amendments to definitions to ensure that the CSDR continues to operate effectively in the UK post exit.

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 the 2018 Act in order 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 the 2018 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 no plans to consolidate the legislation amended by this instrument.

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 European Union (Withdrawal) Act 2018, including on this instrument, in order familiarise them with the legislation ahead of laying. In particular, HM Treasury engaged extensively with the Bank of England and the FCA in the drafting of this legislation.

10.2 The instrument was also published[2] in draft, along with an explanatory policy note, on 22 October 2018, in order to maximise transparency ahead of laying.

11. Guidance

11.1 It is not considered necessary to issue specific guidance in connection with these Regulations.

12. Impact

12.1 The impact on business, charities or voluntary bodies will be limited to the costs of familiarisation with the rules governing CSDs, which will require legal examination of the new legislation. We anticipate this would be achieved through in-house lawyers or external counsel. The main purpose of the instrument is to correct deficiencies in retained law, rather than make policy changes with an impact on UK businesses.

12.2 The impact on the public sector is limited to the Bank of England, PRA and the FCA, who will have to undertake the regulatory obligations as designated competent authorities for the purposes of the CSDR.

12.3 A full Impact Assessment will be published alongside the 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 It is possible that some securities settlement participants or investment firms may be small businesses, however, the Regulations primarily affect the UK's CSD, which is not a small business.

13.2 HM Treasury does not consider that small businesses will be disproportionately affected and has therefore taken the decision not to assist small business. A large number of

[2] www.gov.uk/government/publications/draft-central-securities-depositories-amendment-eu-exit-regulations-2018

businesses, including small businesses, will benefit from the fact that deficiencies in retained EU financial services law arising at the point of exit are addressed, in order to ensure that there continues to be a fully functioning financial services legislative framework.

14. Monitoring & review

14.1 As this instrument is made under the 2018 Act, no review clause is required.

15. Contact

15.1 John Hughes at HM Treasury Telephone: 020 7270 4481 or email: John.Hughes@hmtreasury.gov.uk can answer 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) at HM Treasury 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 <u>may</u> 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 2018 Act 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 2018 Act 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 2018 Act 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 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 2018 Act:

"In my view the Central Securities Depositories (Amendment) (EU Exit) Regulations 2018 does no more than is appropriate".

1.2 This is the case because this instrument only does what is necessary to ensure the UK retains an operative regulatory framework for CSDs post exit. As set out in Section 2, these amendments include: making technical changes to the CSDR to ensure that the UK retains an operative regulatory framework for CSDs in the event of a no deal scenario; transferring the power to make equivalence decisions from the Commission to HM Treasury; transferring powers from ESMA to the Bank of England enabling the Bank of England to recognise third country CSDs post exit; providing a transitional regime so that third country CSDs can continue to provide services to UK firms after exit.

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 2018 Act:

"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 The policy rationale for the provisions contained within this instrument is set out in sections 2 and 7 of the memorandum. The SI addresses deficiencies in UK law and retained EU law that arise from the UK leaving the EU. It forms part of HM Treasury's contingency planning for a no deal scenario, making the necessary changes to ensure the UK continues to have a functioning financial services regime from exit day, regardless of the outcome of negotiations. These provisions ensure a smooth transition after exit day and avoid increased legal uncertainty, costs and inefficiency by minimising disruption to financial markets.

3. Equalities

3.1 The Economic Secretary to the Treasury (John Glen MP) has made the following statement(s)

"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 2018 Act:

"In relation to the instrument, I, the Economic Secretary to the Treasury (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. Criminal offences

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

"In my view there are good reasons for the creation of a criminal offence and for the penalty in respect of it in the Central Securities Depositories (Amendment) (EU Exit) Regulations 2018".

5.2 One effect of this instrument, on exit, is that the existing criminal offence under Regulation 5K(4) of the 2014 Regulations will become relevant to third country CSDs.

6. Legislative sub-delegation

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

"In my view, it is appropriate to create a relevant sub-delegated power in the Central Securities Depositories (Amendment) (EU Exit) Regulations 2018".

6.2 This is appropriate because, as per section 2.3, the various functions and powers designated to the European Securities and Markets Authority (ESMA) must be transferred to the appropriate UK authorities – the Bank of England, the FCA and the PRA. Powers are being transferred, as per section 7.10, to the Bank for the purpose of designating third country CSDs. The Commission's powers to make equivalence decisions are being transferred to HM Treasury (Article 25). Under Article 25 once an equivalence decision is made a third country CSD will be expected to apply for recognition from the Bank of England. The FCA and the PRA will be responsible for drafting the regulatory technical standards to further specify details of the frameworks and tools for monitoring, measuring, management, reporting and public disclosure of credit and liquidity risks.