

EXPLANATORY MEMORANDUM TO

THE CENTRAL SECURITIES DEPOSITORIES REGULATIONS 2017

2017 No. 1064

1. Introduction

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

2. Purpose of the instrument

- 2.1 These Regulations implement in part certain Articles of 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 (“CSDs”) (“the CSD Regulation”) (OJ No L 257, 28.8.2014, p1).
- 2.2 These Regulations contain additional competent authority designations (of the Bank of England (“the Bank”) and Financial Conduct Authority (“the FCA”)) in relation to the CSD Regulation; grant additional enforcement powers to the Bank and FCA; create a new sort of recognised body governed by Part 18 of the Financial Services and Markets Act 2000 (“FSMA”) known as recognised central securities depositories (“RCSDs”); put in place procedures in connection with acquisition of control over RCSDs; require institutions to have appropriate procedures in place for the reporting of infringements; and disapply overlapping provisions of the domestic regime. In addition, they give the Bank the power to make rules codifying the requirement that central counterparties (“CCPs”) notify them of a cyber-incident.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 None

Other matters of interest to the House of Commons

- 3.2 As this instrument is subject to the negative procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

- 4.1 These Regulations implement in part the CSD Regulation, which creates a common authorisation, supervision and regulatory framework for CSDs at EU level. The CSD Regulation aims to harmonise the timing and conduct of securities settlement in the EU and the rules governing CSDs which operate the infrastructures enabling settlement.
- 4.2 The CSD Regulation was submitted for scrutiny to the UK Parliament on 23 March 2012. It was cleared by the House of Commons Scrutiny Committee on 16 October 2013 and the House of Lords European Scrutiny Committee on 26 June 2012.
- 4.3 The CSD Regulation has come into full effect in stages and domestic implementation has therefore been staggered. It was implemented in part by the Central Securities

Depositories Regulations 2014 (S.I. 2014/2879) (“2014 Regulations”). Those Regulations designated the FCA, the Bank and the Prudential Regulation Authority, as competent authorities in relation to different provisions in the CSD Regulation and provided those bodies with powers for the enforcement of the CSD Regulation and for sanctions which apply to the majority of market actors in scope.

- 4.4 Most provisions of the CSD Regulation only have effect once CSDs are authorised, and the EU delegated legislation (“level two”) allowing that authorisation process to start came into force on 30 March 2017 (the level two measures having been published in the Official Journal of the European Union (“OJEU”) on 10 March 2017). These Regulations implement provisions of the CSD Regulation relating to authorisation of CSDs and provisions which are not fully effective until CSDs are authorised. Among other changes these Regulations make additional competent authority designations; grant additional enforcement powers to the Bank and FCA; and disapply domestic law conflicting or overlapping with the CSD Regulation.
- 4.5 One further statutory instrument will be laid to complete the implementation of the CSD Regulation: amendments to the Uncertificated Securities Regulations 2001 (S.I. 2001/3755).

5. **Extent and Territorial Application**

- 5.1 The extent of this instrument is the United Kingdom.
- 5.2 The territorial application of this instrument is the United Kingdom.

6. **European Convention on Human Rights**

- 6.1 The Economic Secretary to the Treasury has made the following statement regarding Human Rights:

“In my view the provisions of the Central Securities Depositories Regulations 2017 are compatible with the Convention rights.”

7. **Policy background**

What is being done and why

- 7.1 On 23 June 2016, the EU referendum took place and the people of the United Kingdom voted to leave the European Union. The government respected the result and triggered Article 50 of the Treaty on European Union on 29 March 2017 to begin the process of exit. Until exit negotiations are concluded, the UK remains a full member of the European Union and all the rights and obligations of EU membership remain in force. During this period the Government will also continue to negotiate, implement and apply EU legislation. The outcome of these negotiations will determine what arrangements apply in relation to EU legislation in future once the UK has left the EU.
- 7.2 CSDs are systemically important financial market infrastructures that underpin the functioning of securities markets. They assume the critical role of guaranteeing the safe and efficient transfer of securities by entering and maintaining securities into their systems and operating securities settlement systems through which securities are delivered to investors or subsequently exchanged.
- 7.3 The CSD Regulation is a directly applicable EU regulation that provides a harmonised regulatory and prudential regime for CSDs, harmonises and increases the robustness

and resilience of securities settlement arrangements and creates a single market for CSD services across the EU. It does this by:

- Establishing the core and ancillary services that a CSD can provide;
- Establishing new common rules for the authorisation and ongoing supervision of CSDs;
- Setting prudential, technical, legal and organisational requirements for the operation of CSDs and their services;
- Harmonising securities settlement rules; and
- Establishing common access rules to support the creation of a competitive single market in securities settlement services.

- 7.4 The CSD Regulation also sets out regulatory roles and responsibilities for competent authorities in support of the above objectives. The 2014 Regulations ensured that a competent authority was designated for all CSD Regulation provisions applicable at that time. These Regulations make further designations in relation to provisions which have full effect only after the publication of level two standards in the OJEU. The Bank is designated as competent authority for European Economic Area (“EEA”) CSDs; third country CSDs; settlement internalisers (firms which settle securities on their own account and not on the account of the CSD) and central counterparties (“CCPs”) for CSD Regulation purposes. The FCA are designated as competent authority for investment firms and participants in securities settlement systems for CSD Regulation purposes.
- 7.5 The Regulations provide the Bank with further powers to carry out their regulatory obligations by extending the FSMA enforcement regime. These include power to carry out inspections of premises, order non-compliant actors to cease their conduct; withdraw authorisations and impose a temporary or permanent ban on management body members. The Regulations also extend the FSMA fines and statement of censure regimes to some actors not included when this regime was extended initially in the 2014 Regulations.
- 7.6 The Regulations also grant the Bank power to require reports from skilled persons or appoint skilled persons to make reports on behalf of a settlement internaliser if a settlement internaliser does not comply with data reporting requirements in the CSD Regulation.
- 7.7 The Regulations permit the Bank to charge fees in order to recover the costs of setting up IT systems necessary to carry out their functions in relation to settlement internaliser reporting.
- 7.8 The Regulations create a new RCSD category through amendments to Part 18 of FSMA (recognised investment exchanges and clearing houses). The UK’s only CSD is currently categorised as a “recognised clearing house” (“RCH”) along with CCPs, but in a 2015 call for evidence respondents agreed that a new category of recognised body should be created to better reflect the differences between CSDs and CCPs.
- 7.9 The CSD Regulation requires that CSDs must have effective default rules in place. Part 7 of the Companies Act 1989 offers insolvency protections needed for the default rules to be effective. This Regulation amends Part 7 to include references to RCSDs where the current text refers to RCHs, the legal category that CSDs previously fell within.

- 7.10 The Regulations provide the Bank with the power to require a person giving notice of a proposal to acquire control of a CSD to produce information or documents and provides for restrictions and civil and criminal sanctions if a person does not comply with CSD Regulation requirements to notify an acquisition of control.
- 7.11 The Regulations require that institutions have appropriate procedures in place for their employees to report actual or potential infringements of the CSD Regulation.
- 7.12 These Regulations also include an amendment to section 293(3) of FSMA in order to satisfy requirements under Directive (EU) 2016/1148 of the European Parliament and of the Council of 6 July 2016 concerning measures for a high common level of security of network and information systems across the Union (“the Directive”) (OJ No L194, 19.7.2016, p1). Article 14(3) of the Directive sets out notification requirements for operators of essential services, which CCPs, regulated by the Bank, are. Although notification by CCPs to the Bank is an expectation, and reportedly does take place in practice, this expectation alone is not considered sufficient to amount to implementation of a measure at least equivalent to the Directive requirement. Accordingly, the Bank need to make rules formally codifying the notification requirement. The rules will satisfy the Directive requirement. In order that the Bank has authority to make such notification rules, the Bank’s authority to make notification rules, provided by section 293(3) of FSMA, is therefore amended to include making rules in respect of notice or information reasonable required for the exercise of the Bank’s functions under the Directive.

Consolidation

- 7.13 There are no current plans to consolidate the legislation amended by this instrument.

8. Consultation outcome

- 8.1 HM Treasury ran a public consultation on the implementation of the CSD Regulation which opened on 8 December 2015 and closed on 4 February 2016. The consultation focussed on competent authority designations; settlement internalisers; recognition and authorisation of CSDs; enforcement powers; the right to issue in an authorised CSD and transitional provisions.
- 8.2 The consultation document sought views concerning two draft statutory instruments: the Central Securities Depositories Regulations 2015 and the Uncertificated Securities (Amendment) Regulations 2015. The government has decided that a separate response document will be published for questions relating to each statutory instrument. A response document focussing on the Central Securities Depositories Regulations 2017 was published on 11 September 2017 whilst another response document focusing on Uncertificated Securities (Amendment) Regulations 2018 will be published in due course.
- 8.3 The Treasury received 3 responses to the consultation document. It has considered each response carefully and made a number of changes to the drafts Regulations to take account of comments received.
- 8.4 Respondents broadly agreed with the Treasury’s proposed positions on most issues.
- 8.5 In the consultation document, the government also sought views on if the Bank should be given additional powers of investigation and enforcement in relation to EEA CSDs where they have become of systemic importance and also where they persist in infringing the CSD Regulation in spite of measures taken by the home competent

authority. The government has concluded that the Bank's powers in respect of EEA CSDs should be more extensive than those provided for in the consultation draft in order to support their functions under Article 24 of the CSD Regulation.

- 8.6 The government also queried whether it is appropriate to give the Bank of England any information-gathering or enforcement powers in respect of third country CSDs providing services in the UK. The government considers that since the European Securities and Markets Association (ESMA) is required to put in place cooperation agreements with third country competent authorities in Article 25 of the CSD Regulation, and the competent authorities of the EEA host state should work in close cooperation with ESMA, it is not appropriate to provide for the Bank of England with specific information-gathering or enforcement powers in respect of third country CSDs.
- 8.7 A more detailed analysis of the consultation outcome and the Treasury's policy response to the opinions expressed can be found at:
www.gov.uk/government/consultations/consultation-on-the-implementation-of-the-central-securities-depositories-regulation-csdr

9. **Guidance**

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

10. **Impact**

- 10.1 There is no direct impact on business, charities or voluntary bodies. Any impact stemming from the enforcement of these powers is as a direct result of the CSD Regulation, not from these domestic Regulations.
- 10.2 The impact on the public sector is limited to the FCA and the Bank who will have to undertake the regulatory obligations as designated competent authorities for the purposes of the CSD Regulation.
- 10.3 An Impact Assessment has not been prepared as there are no direct costs on business associated with this instrument.

11. **Regulating small business**

- 11.1 The legislation does apply to activities that are undertaken by small business.
- 11.2 It is possible that some securities settlement participants or investment firms may be small businesses, however the Regulation primarily affects the UK's CSD, which is not a small business, and we do not consider that small businesses will be disproportionately affected. HMT has not therefore taken a decision to assist small business.

12. **Monitoring & review**

- 12.1 The instrument amends the 2014 Regulations to the effect that both sets of Regulations must be reviewed together. HM Treasury must review the Regulations every five years and set out the conclusions of each review in a published report. The first report, which must be published by 21 November 2019, will set out the objectives intended to be achieved by the regulatory provisions.

13. **Contact**

- 13.1 Anthony Demetriou at HM Treasury Telephone: 020 7270 1657 or email: Anthony.Demetriou@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.