

EXPLANATORY MEMORANDUM TO

**THE FINANCIAL SERVICES AND MARKETS ACT 2000 (CENTRAL
COUNTERPARTIES, INVESTMENT EXCHANGES, PROSPECTUS AND
BENCHMARKS) (AMENDMENT) REGULATIONS 2020**

2020 No. 117

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 make a series of necessary minor updates to UK law in order to ensure that the UK financial services framework remains fully effective and enforceable following the introduction of new EU legislation. These Regulations are necessary to implement three European Union regulations and one European Union directive related to financial services.

2.2 The four pieces of legislation which are implemented via these Regulations, and the nature and purpose of the necessary updates to UK law, are listed in sections 2.3 to 2.9 below, and in more detail in section 7.

EMIR 2.2

2.3 These Regulations make small changes in UK law to implement Regulation (EU) 2019/2099 of the European Parliament and of the Council of 23 October 2019 (known as “EMIR 2.2” or “EMIR supervision”). EMIR 2.2 amends the European Market Infrastructure Regulation (known as “EMIR”) to introduce an updated third country central counterparty (“CCP”) supervision framework.

2.4 These Regulations amend the definition of EMIR in UK law in order to ensure that EMIR continues to be fully effective and enforceable in the UK following the updates in EMIR 2.2. No other changes are required to implement the changes in UK law.

SME Growth Markets Regulation

2.5 These Regulations make a small change in UK law to implement Regulation (EU) 2019/2115 of the European Parliament and of the Council of 27 November 2019 amending Directive 2014/65/EU and Regulations (EU) No 596/2014 and (EU) 2017/1129 as regards the promotion of the use of SME Growth Markets (known as the “SME Growth Markets Regulation”).

2.6 This is to clarify that the Financial Conduct Authority is designated as the supervisory authority for the purpose of issuing prior approval of ‘exempted documents’ under Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC (known as the “Prospectus Regulation”).

Low Carbon Benchmarks Regulation

- 2.7 These Regulations make a small change in UK law to implement Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks (known as the “Low Carbon Benchmarks Regulation”). This is to ensure that the Financial Conduct Authority (“FCA”) will be able to apply its powers to enforce obligations in relation to low carbon benchmarks.

Investment Firms Directive amendment to MiFID II

- 2.8 These Regulations make a small change in UK law to transpose the amendment introduced by Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms (the Investment Firms Directive) amending Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments (MiFID II) as regards the tick size regime.
- 2.9 This small amendment clarifies that trading venues operated by stock exchanges can execute trades at mid-point between tick sizes for large orders. The UK is under the obligation to transpose this amendment by 26 March 2020.

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 As the instrument is subject to negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

4. Extent and Territorial Application

- 4.1 The territorial extent of this instrument is the United Kingdom.
- 4.2 The territorial application of this instrument is the 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 Financial Services and Markets Act 2000 (Central Counterparties, Investment Exchanges, Prospectus and Benchmarks) (Amendment) Regulations 2020 are compatible with the Convention rights.”

6. Legislative Context

- 6.1 These Regulations implement amendments to three EU regulations and one directive related to financial services. These files are: EMIR 2.2, the SME Growth Markets Regulation, the Low Carbon Benchmarks Regulation, and the Markets in Financial Instruments Directive as amended by the Investment Firms Directive.

- 6.2 All three regulations make updates to earlier EU regulations. EMIR 2.2 updates the European Market Infrastructure Regulation (known as “EMIR”), which was adopted in 2012. The SME Growth Market Regulation updates the Prospectus Regulation, which was adopted in 2017. The Low Carbon Benchmarks Regulation updates the Benchmarks Regulation which entered into force in 2016.
- 6.3 As these three files are directly applicable EU regulations, the changes will automatically have effect in UK law from the date they apply without extensive implementing regulations. However, to ensure that the relevant regulatory frameworks continue to be a fully effective and enforceable, some minor changes are required to UK law to reflect the updates.
- 6.4 These Regulations update the definition of EMIR in primary legislation in section 313 of the Financial Services and Markets Act 2000. In addition, definitions are updated in the following secondary legislation: The Financial Services and Markets Act 2000 (Qualifying EU Provisions) Order 2013; The Financial Services and Markets Act 2000 (Over the Counter Derivatives, Central Counterparties and Trade Repositories) Regulations 2013; The Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017; The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.
- 6.5 These Regulations also amend secondary legislation to resolve an ambiguity in the application of the SME Growth Markets Regulation in the UK. Specifically, regulation 8 amends the Financial Services and Markets Act 2000 (Prospectus) Regulations 2019 to provide clarity over which UK regulator is responsible for a specific function under the Prospectus Regulation.
- 6.6 In addition to the three regulations above, these regulations give effect to an amendment to MiFID II as introduced by the Investment Firms Directive as required to be implemented by 26th March 2020. These Regulations amend the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges, Clearing Houses and Central Securities Depositories) Regulations 2001 to give effect to an amendment to MiFID II as introduced by the Investment Firms Directive.
- 6.7 These updates are made under section 2(2) of the European Communities Act 1972. The European Communities Act 1972 was repealed by section 1 of the European Union (Withdrawal) Act 2018 with effect from exit day, but saved with modifications until IP completion day by section 1A of that Act (as inserted by section 1 of the European Union (Withdrawal Agreement) Act 2020).

7. Policy background

What is being done and why?

- 7.1 In 2019, several updates to finance services law came into application in the EU. Due to these updates, it is necessary to make minor changes to UK law to ensure the UK’s financial services framework remains fully effective and enforceable in the UK.

EMIR 2.2

- 7.2 In the EU, the G20 commitment to clear over the counter (OTC) derivatives in a CCP was implemented in EMIR. On 13th June 2017 the European Commission proposed EMIR 2.2, which updates the original EMIR framework for third country CCPs. This

action was prompted by the significant use of CCPs from outside of the EU by EU firms, which will include the United Kingdom following EU Exit.

- 7.3 CCPs are financial institutions which firms use to reduce the risk arising from some trades. They guarantee that transactions will be honoured if the other party defaults. CCPs do this by standing between the parties of a trade, becoming the buyer to every seller and the seller to every buyer
- 7.4 EMIR 2.2 was approved by the European Parliament and Council and published in the Official Journal of the European Union on 12 December 2019. It entered into application in its entirety on 1st January 2020.
- 7.5 As a regulation, EMIR 2.2 is directly applicable in the UK, so no comprehensive implementation in UK law is necessary. These regulations are solely necessary in order to update certain definitions of EMIR in UK law, in order to reflect the fact that EMIR has been updated by EMIR 2.2.

SME Growth Markets Regulation

- 7.6 The SME Growth Market Regulation makes amendments to the Prospectus Regulation – which contains the standardised prospectus rules that apply across all European Economic Area Member States; Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC (known as the “Market Abuse Regulation”); and Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast) (known as “MiFID II”). The changes introduced by these amendments include:
- i. Allowing issuers whose securities have traded on an SME Growth Market - such as the Alternative Investment Market (‘AIM’) in the UK - for two years to seek admission of such securities to trading on a regulated market with the use of a simplified prospectus; and
 - ii. Widening the types of issuers that can make use of the lighter, less burdensome EU Growth prospectus.
- 7.7 The amendments introduced to the Prospectus Regulation by the SME Growth Market Regulation have applied since 31 December 2019. However, the underlying technical regulations related to one of these provisions have not yet been published and therefore are not yet fully operational. Additionally, the drafting of one of the provisions is ambiguous. This creates uncertainty around one of the exemptions contained in the Prospectus Regulation.
- 7.8 This exemption allows issuers to forgo producing a prospectus when securities are offered in connection with certain forms of takeover - when one company acquires or assumes control of another company, during which process securities can be offered – provided an ‘exempted document’ containing minimum information describing the transaction and its impact on the issuer is produced.
- 7.9 The SME Growth Market Regulation amends this exemption by restricting it to specific scenarios and by requiring prior approval of certain ‘exempted documents’ by the appropriate regulator. However, the amendments introduced by the SME

Regulation make it unclear as to who the appropriate regulator is in the context of the UK regime.

- 7.10 To provide clarity, this instrument sets out that this function will be undertaken by the FCA. The FCA is the appropriate authority to approve the ‘exempted document’ (which is a document that can be produced in lieu of a prospectus) as the FCA is the supervisory authority for the purposes of the Prospectus Regulation, which includes the scrutiny and approval of prospectuses. This will provide certainty and continuity for market participants, as the FCA undertook a similar role under the previous prospectus regime set by the Prospectus Directive.

Low Carbon Benchmarks Regulation

- 7.11 The EU Benchmarks Regulation entered into force in 2016, and sets out a regulatory framework for benchmark provision and usage in the EU. The Low Carbon Benchmarks Regulation amends the EU Benchmarks Regulation to include new categories of low carbon benchmarks (“climate transition benchmarks” and “Paris-aligned benchmarks”) into the framework.
- 7.12 It aims to enhance the transparency and comparability of low carbon benchmarks to enable investors to make more informed decisions. It also increases the length of time that national competent authorities can compel administrators to publish a critical benchmark from two years to five years.
- 7.13 This instrument will amend the relevant UK legislation which gives the FCA powers to enforce against directly applicable EU legislation. This is to ensure that the FCA can enforce any obligation in relation to low carbon benchmarks and have other powers (for example fees and statutory immunity) related to its functions.

The Investment Firms Directive

- 7.14 Together with Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms (the “Investment Firms Regulation”), the Investment Firms Directive introduce more proportionate prudential rules for investment firms. The Investment Firms Directive amends MiFID II, among other Directives, to give effect to the new prudential regime. While the majority of the regime will become operational in the EU on 26 June 2021, it is necessary to transpose one of these amendments by 26 March 2020.
- 7.15 This small amendment clarifies that trading venues operated by stock exchanges can execute trades at mid-point between tick sizes (set movements in price) for large orders. This will provide legal certainty to market participants and legitimise current market practice in the UK.

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

- 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 does not consolidate any other instrument.

10. Consultation outcome

- 10.1 The changes introduced in these Regulations do not require a consultation because, as directly applicable EU regulations with requirements and obligations which apply without implementation into domestic law, the Treasury needs only to ensure that existing domestic legislation remains consistent. In addition, the changes introduced to the MiFID II are minor and reflect existing market practice.
- 10.2 As there is a very limited way in which a consultation could affect the draft legislation, no consultation was necessary.

11. Guidance

- 11.1 HM Treasury does not propose to provide any guidance in relation to these Regulations. The European Securities and Markets Authority (ESMA) and the competent authorities within the UK (the Bank of England and the Financial Conduct Authority) have the power to issue guidance in relation to these regulations.

12. Impact

- 12.1 There is no, or no significant, impact on business, charities or voluntary bodies. HM Treasury anticipates a small impact on stock exchanges to reflect necessary system updates. As these Regulations reflect current market practice, and this change is only necessary for a single stock exchange, the impact will be minor.
- 12.2 There is no, or no significant, impact on the public sector. While this SI assigns responsibilities to the FCA, in reality this serves to simply clarify the role that the FCA already has had in these areas.
- 12.3 A full impact assessment has not been prepared for this instrument due to the low level of impact on business (less than net £5 million EANDCB-Equivalent Annual Net Direct Costs to Business). A de minimis impact assessment has been carried out, confirming this small estimated business impact.

13. Regulating small business

- 13.1 The legislation applies to activities that are undertaken by small businesses.
- 13.2 No specific action is proposed to minimise regulatory burdens on small businesses. This is because these Regulations simply clarify existing regulatory responsibilities and do not introduce new burdens for businesses. While HM Treasury has identified a minor impact on a minority of stock exchanges, such exchanges are not small businesses.

14. Monitoring & review

- 14.1 These Regulations do not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015, John Glenn MP has made the following statement:

“In my view, it is not appropriate to include a statutory review clause in The Financial Services and Markets Act 2000 (Central Counterparties, Investment Exchanges, Prospectus and Benchmarks) (Amendment) Regulations 2020 because it would be disproportionate taking into account the low economic impact of the regulatory provisions contained in these Regulations”.

15. Contact

- 15.1 Tim Garbutt at HM Treasury Telephone: 02072705601 or email: tim.garbutt@HMTreasury.gov.uk can be contacted with any queries regarding the instrument.
- 15.2 Tom Duggan, Deputy Director for Securities, Markets and Banking, at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.
- 15.3 John Glen, Economic Secretary to the Treasury at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.