

Consultation Paper

UK withdrawal from the EU: Changes to FMI rules and onshored Binding Technical Standards

October 2018



BANK OF ENGLAND





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The response will be assessed to inform our work as a regulator and central bank, both in the public interest and in the exercise of our official authority. We may use your details to contact you to clarify any aspects of your response.

The consultation paper will explain if responses will be shared with other organisations (for example, the Financial Conduct Authority). If this is the case, the other organisation will also review the responses and may also contact you to clarify aspects of your response. We will retain all responses for the period that is relevant to supporting ongoing regulatory policy developments and reviews. However, all personal data will be redacted from the responses within five years of receipt. To find out more about how we deal with your personal data, your rights or to get in touch please visit bankofengland.co.uk/legal/privacy.

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Responses are requested by Wednesday 2 January 2019.

Please address any comments or enquiries to:

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1 Overview

1.1 The UK's withdrawal from the European Union (EU)¹ requires changes to be made to United Kingdom (UK) legislation to ensure that it remains functional. The European Union (Withdrawal) Act 2018 (the Act) converts directly applicable EU law (eg EU Regulations) into UK law, and preserves domestic law that relates to EU membership (including domestic law that was introduced to implement EU Directives). This body of law is referred to as 'retained EU law'. The Act also provides Government ministers powers to make changes to the law so that it continues to operate effectively after the UK's withdrawal from the EU. These processes are often referred to as 'onshoring' or 'Nationalising the Acquis'² (NtA).³

1.2 This consultation paper (CP) sets out the Bank of England's (the Bank) proposals to fix deficiencies arising from the UK's withdrawal from the EU in its capacity as competent authority for financial market infrastructures (FMIs). This encompasses fixing deficiencies in FMI-related Binding Technical Standards (BTS) and the Bank's domestic rules for FMIs (FMI rules). This CP also covers the Bank's proposed approach to interpreting certain Bank issued non-binding material.

1.3 This CP is relevant to FMIs supervised by the Bank,⁴ as well as market infrastructures and market participants more generally.

1.4 This CP is published as part of the Bank of England's consultation package on amending financial services legislation under the Act.⁵ As explained in CP25/18 'The Bank of England's approach to amending financial services legislation under the European Union (Withdrawal) Act 2018' (the 'NtA approach CP'), HM Treasury has proposed to delegate powers under the Act to the financial services regulators (Financial Conduct Authority (FCA), PRA, Bank and Payment Systems Regulator (PSR)),⁶ giving them responsibility for fixing deficiencies in onshored BTS.⁷

1.5 In this CP, the Bank is consulting on fixes to deficiencies arising from the UK's withdrawal from the EU in onshored BTS that the Bank as FMI supervisor will be responsible for under the Schedule of the 'Financial Regulators' powers, (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018' (the Regulations). The delegated powers may also be used by the regulators to amend deficiencies within their respective rules. Therefore, the Bank expects to have the power to make 'EU exit instruments', where appropriate, to prevent, remedy or

¹ References in this CP to the EU and/or its Member States include, as appropriate, the European Economic Area (EEA) States of Norway, Iceland and Liechtenstein.

² Acquis refers to the 'acquis communautaire'.

³ HM Treasury has set out its approach to onshoring EU financial services regulation in 'HM Treasury's approach to financial services legislation under the European Union (Withdrawal) Act', June 2018: <http://www.gov.uk/government/publications/financial-services-legislation-under-the-eu-withdrawal-act>.

⁴ The Bank has legal powers to supervise ten FMIs covering three types of FMIs (central counterparties; central securities depositories; payment systems). For further information, see 'The Bank of England's supervision of financial market infrastructures – Annual Report 2018': <https://www.bankofengland.co.uk/news/2018/february/supervision-of-financial-market-infrastructures-annual-report-2018>.

⁵ The Bank and PRA has issued four consultation papers on Thursday 25 October 2018, available at: <http://www.bankofengland.co.uk/news/2018/october/boes-approach-to-amending-financial-services-legislation-under-the-eu-withdrawal-act-2018>.

⁶ 'The Financial Regulators' Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018' draft SI (the 'Regulations').

⁷ In addition to the power to address deficiencies, the Regulations also delegate to the regulators (Financial Conduct Authority, PRA, Bank and Payment Systems Regulator) an ongoing power to make and maintain BTS. These powers cannot be exercised until after the UK has left the EU.

mitigate any failure of the BTS within the Bank's remit and FMI rules to operate effectively or any other deficiency in these BTS or FMI rules arising from the UK's withdrawal from the EU.

1.6 As set out in the NtA approach CP, HMT is responsible for addressing deficiencies in primary and secondary UK financial services legislation that arise following the UK's withdrawal from the EU. The changes proposed to onshored BTS and FMI rules in this CP are consistent with, and in some cases consequential upon, changes that HMT proposes to make to relevant legislation, and should be read in conjunction with those changes. This CP focuses on changes where the Bank proposes to depart from the general approach described in Chapter 3 and 4 of the NtA approach CP, or where the Bank considers that further explanation is appropriate. The two documents should be read together. This CP does not describe those changes which are simply consequential on changes proposed by HM Treasury to relevant legislation.

1.7 The Government has committed to give the financial services regulators transitional powers to enable firms to adjust to changes made as a result of onshoring. As set out in the NtA approach CP, the Bank is considering exercising the transitional powers in a broad way to delay the application of onshoring changes that will alter the regulatory standards that apply to FMIs, in the eventuality that there is no Implementation Period.⁸ This is set out in the NtA approach CP, and the Bank will continue to consider its approach to the potential use of the temporary transitional power, including in light of response received to this CP.

1.8 The changes proposed in this CP are technical amendments to ensure an operable legal framework for the day the UK leaves the EU on 29 March 2019 (exit day).⁹ The powers delegated to the Bank under the Act can only be used to fix 'deficiencies' that arise as a result of the UK's withdrawal from the EU. They cannot be the basis for policy changes unrelated to the UK's withdrawal from the EU. As such, the format and content of this CP has different elements compared to a usual Bank consultation on rules under the Financial Services and Markets Act 2000 (FSMA). Statutory FSMA requirements, for example to undertake cost benefit analysis, do not apply to the exercise of the powers under the Act.

1.9 The responsibility for some onshored BTS is shared between the FCA and Bank (joint BTS). Where this is the case, the approach is that one regulator will take the lead in proposing amendments in close consultation with the other relevant regulator, based on which regulator's remit and objectives are most relevant to the joint BTS. The FCA will separately consult on the BTS it has been assigned, and the Bank recommends that relevant FMIs, market infrastructures and market participants also review its consultations.

1.10 Under the Regulations, regulators also have the option to retain joint BTS as joint or divide them so that, for example, there is a Bank version for Central Counterparties (CCPs) and an FCA version for other trade counterparties. The Bank is not proposing to subdivide any of the BTS that are in the Bank's remit as FMI regulator.

1.11 As set out in the NtA approach CP, the changes proposed in this CP would take effect on the exit date of 11:00pm Friday 29 March 2019 only in the event that there is no Implementation Period. If the draft Withdrawal Agreement agreed between the UK and EU¹⁰ is

⁸ A draft Withdrawal Agreement was agreed between the UK and EU in March 2018. The draft Withdrawal Agreement provides for an implementation period ending on Thursday 31 December 2020 (the 'Implementation Period').

⁹ As defined in the Act.

¹⁰ 'Draft Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community', March 2018: <https://www.gov.uk/government/publications/draft-withdrawal-agreement-19-march-2018>.

ratified and the Implementation Period commences on Friday 29 March 2019, the proposed changes would not take effect until after the end of the Implementation Period. To the extent that it is necessary, further modifications to FMI rules and onshored BTS may be required to reflect any agreement that is reached between the UK and EU on their future relationship.

1.12 The Bank proposes in this CP only to make changes to FMI rules and onshored BTS that were adopted before Sunday 1 July 2018.¹¹ The changes proposed in this CP are based on draft Statutory Instruments (SIs)¹² that have been published or laid before Parliament before publication of this CP. The Bank will also consult on any further changes to FMI rules and onshored BTS after relevant SIs which reflect the Government's policy in relation to these issues have been published.

1.13 The rest of the document is structured as follows:

- Chapter 2 sets out how to interpret certain Bank materials related to the Bank's role as FMI competent authority in the context of the UK's withdrawal from the EU;
- Chapter 3 sets out those changes to onshored BTS which deviate from the approach set out in the NtA approach CP or where the Bank's approach requires further explanation;
- Chapter 4 sets out the proposed approach to amending the deficiencies arising from UK's withdrawal from the EU in FMI rules; and
- Chapter 5 sets out the Bank's obligations under the Regulations.

1.14 The appendices to this CP consist of:

- Appendix 1: Draft Supervisory Statement 'Non-binding Bank materials: The Bank's approach after the UK's withdrawal from the EU in relation to Financial Market Infrastructure supervision';
- Appendix 2: Draft FMI rule changes; and
- Appendix 3: Draft BTS EU Exit Instruments within the Bank's remit as FMI competent authority

Responses and next steps

1.15 This consultation closes on Wednesday 2 January 2019. The Bank invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to: fmibts@bankofengland.co.uk.

¹¹ Any BTS that come into force after this date will be considered in later CPs.

¹² The EMIR SI was published on 22 October 2018:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/750328/Over-the-Counter-Derivatives-Draft-SI.PDF.

The CSDR SI was published on 22 October 2018: <https://www.gov.uk/government/publications/draft-central-securities-depositories-amendment-eu-exit-regulations-2018/draft-central-securities-depositories-amendment-eu-exit-regulations-2018-explanatory-information>.

2 Interpreting the Bank's supervisory approach documents and other guidance relating to FMI supervision

2.1 This chapter covers the Bank's proposal on the treatment of Bank guidance, for example the Bank's supervisory approach documents and Statements of Policy, issued in the Bank's role as FMI competent authority in effect on exit day. The draft Supervisory Statement in Appendix 2 provides a list of relevant materials, as well as guidance on how these materials should be interpreted when the UK leaves the EU. The draft Supervisory Statement sets out that the Bank will not be making detailed amendments to these materials ahead of the UK's withdrawal from the EU. The Bank proposes that FMIs interpret these materials in the context of the UK's withdrawal from the EU, the changes made to related legislation, the proposed amendments to FMI rules, and the proposed amendments to BTS under the Act.

2.2 The Bank has previously communicated that it is planning an update of 'The Bank of England's approach to FMI supervision'¹³ in due course to clarify its objectives in light of a recommendation from the Bank's Independent Evaluation Office to 'provide a fuller articulation of the Bank's FMI supervisory strategy and objectives'.¹⁴ The Bank does not propose any further update to this document ahead of exit day to reflect the UK's withdrawal from the EU.

2.3 For the Bank's approach to EU Guidelines and Recommendations issued by the European Supervisory Authorities (ESA), readers are referred to the NtA approach CP.

¹³ The Bank's approach to FMI supervision: <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability/financial-market-infrastructure-supervision/the-boe-approach-to-the-supervision-of-fmi.pdf>.

¹⁴ The Bank provided a response to the Independent Evaluation Office's evaluation: <https://www.bankofengland.co.uk/-/media/boe/files/independent-evaluation-office/2017/boe-response-to-the-ieo-evaluation-of-fmi-supervision.pdf>.

3 Amendments to onshored Binding Technical Standards for FMIs

3.1 The Bank is consulting in this CP on those European Market Infrastructure Regulation (EMIR)¹⁵ and Central Securities Depositories Regulation (CSDR)¹⁶ BTS that are the responsibility of the Bank (as per the Regulations) in its capacity as FMI competent authority. The draft EU exit instruments which provide for the changes to BTS the Bank is proposing to make to fix deficiencies arising from the UK's withdrawal from the EU are contained in Appendix 3.

3.2 This chapter does not comment on each proposed amendment. The Bank considers it appropriate to provide specific commentary on proposed changes that represent a departure from the approach set out in the NtA approach CP and where the Bank considers that an explanation would be appropriate to make clear the rationale for maintaining the general approach. These proposed changes are set out below.

3.3 All proposed changes are included in Appendix 3, which contains all the draft EU exit instruments.

1) EMIR Intragroup exemptions

3.4 In the EMIR SI, HM Treasury introduces transitional provisions governing intragroup exemptions from certain provisions between group entities in the UK and entities in the European Economic Area or a third country. One element of this regime supplants the existing transitional intragroup exemptions contained in Article 3(2) of the EMIR clearing obligation BTS (2016/1178, 2015/2205 and 2016/592). Therefore, these Articles are deleted in the relevant draft EU exit instruments, and the cross-references to these Articles in Article 4(3) and 4(4) of the clearing obligation BTS are amended to refer to the new transitional regime.

2) References to European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM)

3.5 Annex II of EMIR BTS (153/2013) and Article 81 of CSDR BTS (2017/392) specify that financial instruments can be considered highly liquid and bearing minimal credit and market risk if they meet certain conditions. One type of instrument that may be considered eligible is debt instruments issued or guaranteed by the EFSF or ESM.¹⁷

3.6 The standard approach to fixing deficiencies in onshored BTS is to treat EU or EU-related institutions as a third country rather than retain preferential treatment for the EU or EU instruments. However, the treatment of certain debt instruments issued or guaranteed by the EFSF and ESM is not a deficiency arising from the UK's withdrawal from the EU. Their inclusion is aligned with standards agreed by the Basel Committee on Banking Supervision in relation to capital and liquidity requirements for banks clarifying that instruments issued or guaranteed

¹⁵ Regulation (EU) No 648/2012.

¹⁶ Regulation (EU) No 909/2014.

¹⁷ The same treatment is applied to debt instruments issued or guaranteed by governments, central banks, or a set of multilateral development banks listed in an Annex to Directive 2006/48/EC.

by certain international organisations should be treated as highly liquid, and that banks may assign claims on the EFSF and ESM a 0% risk weight.¹⁸

3.7 The Bank proposes to retain the references to EFSF and ESM in the onshored EMIR and CSDR BTS, as doing so will maintain consistency with internationally agreed standards.

3) Geographical scope of CSDs contained in application information concerning groups

3.8 Article 7 of the CSDR BTS (2017/392) requires firms applying to be authorised as a CSD to provide information on their parent undertaking and on services that they share with other undertakings in a group, if that group contains other CSDs or credit institutions designated to provide banking-type ancillary services.

3.9 The definition of a CSD in the SI (Central Securities Depositories (Amendment) (EU Exit) Regulations 2018) is limited to CSDs established in the UK (as opposed to the EU). The approach set out in the NtA approach CP would therefore mean that if a CSD which is applying for authorisation in the UK is part of a group which includes non-UK CSDs, that group would not be captured in the information to be provided in an authorisation application.

3.10 Information about the wider group is important in understanding the risks that a CSD might be exposed to, and therefore relevant for the Bank to consider as part of the authorisation process. Therefore the Bank proposes to broaden the scope of 'other CSDs' in this specific obligation to include groups of undertakings that contain any non-UK CSDs.

4) Covered bonds

3.11 There are references to covered bonds in Article 1(2) of each of BTS 2016/1178 and 2015/2205 (which specify certain contracts as subject to the clearing obligation). These provisions cross-refer to the Capital Requirements Regulation (575/2013) (CRR); the onshoring of the relevant provisions in the CRR limit their scope to domestic (UK) covered bond issuers.¹⁹ Non-UK covered bond issuers may therefore fall outside these definitions.

3.12 This consultation is seeking feedback on any potential effects of applying the approach set out in the NtA approach CP in these instances.

5) Deleted BTS

3.13 A number of EMIR BTS and CSDR BTS within the Bank's remit as FMI competent authority will need to be deleted, as the requirements set out in these BTS will no longer be applicable following the UK's withdrawal from the EU. For example, UK regulators will not be under binding obligations to share information under the BTS covering EU colleges and exchange of information between EU supervisory authorities and these will be deleted. This deletion will be done through an EU exit instrument which deletes the relevant onshored BTS in retained EU law.

¹⁸ See this publication from the Basel Committee on Banking Supervision in relation to the capital and liquidity treatment for the ESM and EFSF: https://www.bis.org/publ/bcbs_n17.htm.

¹⁹ See the draft legislation relating to the onshoring of the CRR here: https://assets.publishing.service.gov.uk/mwg-internal/de5fs23hu73ds/progress?id=xvHV2u9AU41_xRgm519TvWM2-SV6TtBOvHh7oFAWmr0.

4 Amendments to the Bank's domestic rules for FMIs

4.1 In addition to the proposed fixes in onshored BTS and approach to non-binding Bank materials, the Bank is also consulting on amendments to the Bank's FMI rules. The power to fix deficiencies in rules will be delegated by HMT to the regulators via the Regulations.

4.2 There are currently four Recognised Clearing House (RCH) rules made by the Bank of England under the Financial Services and Markets Act 2000.²⁰ RCH 2 and RCH 4 currently contain references to EU legislation. The Bank proposes to amend these RCH rules in line with the approach set out in the NtA approach CP. Appendix 2 sets out the proposed new language of the rules on which this CP is consulting.

4.3 RCH 2 stipulates the extent of duty and notice requirements for UK RCHs with respect to regulatory provisions. Section 2.3 outlines that the duty does not apply to the extent it is required under EU law or any enactment or rule of law in the UK. UK RCHs will not be subject to EU law in relation to their operations within the UK after the UK's withdrawal from the EU, therefore the Bank proposes to remove the reference to EU law in RCH 2.

4.4 RCH 4 stipulates the requirement for UK CCPs to notify the Bank of certain incidents having an impact on their information technology systems. Section 4.5(b) defines 'information technology system', which includes a 'network and information system' as such term is defined in the Directive on Security of Network and Information Systems.²¹ This is an EU-derived definition. The Bank proposes to amend the definition of 'information technology system' to include 'network and information system' as defined in regulation 1(2) of The Network and Information Systems Regulations 2018,²² which is domestic legislation. From a comparison of the current definition of network and information system within Directive 2016/1148/EC against the definition in The Network and Information Systems Regulations 2018, the Bank considers that they are substantively similar.

²⁰ The Recognised Clearing House Rules, RCH 1-3, can be found on the Bank website: <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability/financial-market-infrastructure-supervision/recognised-clearing-houses-rules.pdf>. The Recognised Clearing House Rule, RCH 4, can be found on the Bank website: <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability/financial-market-infrastructure-supervision/recognised-clearing-house-rules-instrument-2018.pdf>.

²¹ Directive 2016/1148/EC, Article 4(1).

²² The current UK legislation can be found here: <http://www.legislation.gov.uk/ukSI/2018/506/made>.

5 The Bank's obligations under the Regulations

5.1 HM Treasury has delegated a power, under Section 8 of the Act, to the Bank to make changes to Bank rules and relevant BTS. As such, similar restrictions that apply to the power in Section 8 also apply to the Bank's delegated power. Different constraints will exist in relation to the transitional power as highlighted in Chapter 4 of the NtA approach CP.

5.2 In accordance with those restrictions, the Bank considers that all changes proposed to Rules and BTS in this CP are appropriate to prevent, remedy or mitigate any:

- (a) failure of the relevant Bank rules or BTS to operate effectively; or
- (b) other deficiency in the relevant Bank rules or BTS, arising from the UK's withdrawal from the EU.

5.3 The types of changes that fall within the scope of 'deficiency' are listed in Section 8(2) of the Act. This list is exhaustive, ie all amendments must address deficiencies of these types or make consequential, supplementary, transitory or transitional provision in connection with them.

5.4 The Bank also confirms that the proposed Rule and BTS changes made under the Act do not:

- (a) impose or increase taxation or fees;
- (b) make retrospective provision;
- (c) create a criminal offence which is capable of leading to imprisonment of more than two years;
- (d) establish a public authority;
- (e) implement the Article 50 Withdrawal Agreement;
- (f) result in the transfer of a function of an EU authority to a UK authority;
- (g) confer any power to legislate by means of orders, rules, regulations or any other subordinate instrument; or
- (h) amend any legislation other than the relevant Bank rules or BTS.

Equality and diversity

5.5 The Bank has performed an assessment of the policy proposals and does not consider that the proposals give rise to equality and diversity implications.

Appendices

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Appendix 1: Draft Supervisory Statement 'Non-binding Bank materials relating to Financial Market Infrastructure Supervision: The Bank's approach after the UK's withdrawal from the EU'

1 Introduction

1.1 HM Treasury has set out its intention to ensure that the UK will continue to have a functioning financial services regulatory regime regardless of the outcome of negotiations with the EU.¹ Their approach is to ensure that EU-derived laws and rules that are currently in place in the UK will continue to apply at the point of exit to the extent that they remain operable in a UK regime. Changes will only be made to those laws or rules that would otherwise not operate appropriately. This will provide continuity and certainty for firms as the UK leaves the EU.

1.2 This statement sets out how Financial Market Infrastructures (FMIs) should interpret existing Bank supervisory materials in light of the UK's withdrawal from the EU.

1.3 This statement is relevant to all Bank supervised FMIs operating, or intending to operate, in the United Kingdom. The Bank may issue further expectations in relation to this topic.

2 Supervisory expectations for FMIs on the UK's exit from the EU

2.1 The Bank of England has issued various materials in relation to its supervision of FMIs:

- The Bank of England's approach to the supervision of FMIs.
- The Bank of England's approach to the supervision of services providers to recognised payments.
- The Policy Statement on financial penalties imposed by the Bank under FSMA 2000 or under part 5 of the Banking Act 2009.
- The implementation by the Bank of England of ESMA's guidelines and recommendations on CCP interoperability arrangements.
- The Policy Statement on the giving of directions to qualifying parent undertakings of UK recognised clearing houses.
- The statutory statements of procedure in respect of the Bank of England's supervision of financial market infrastructures.
- The guidance on recognised clearing houses for insolvency practitioners.
- Other relevant material on the Bank's financial market infrastructure supervision website.²

¹ See HM Treasury's approach to financial services legislation under the European Union (Withdrawal) Act 2018, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/720298/HM_Treasury_s_approach_to_financial_services_legislation_under_the_European_Union_Withdrawal_Act.pdf.

² All relevant material can be found on the Bank website: <https://www.bankofengland.co.uk/financial-stability/financial-market-infrastructure-supervision>.

2.2 The Bank is not intending to make line-by-line amendments to the material listed above ahead of the UK's withdrawal from the EU. Firms should read and interpret these materials in light of the UK's withdrawal from the EU, as well as the amendments that have been made to related legislation, including FMI rules and Binding Technical Standards, under the European Union (Withdrawal) Act 2018. For example, references to the role of the European Supervisory Authorities (ESAs) or to colleges established under EU law would no longer be relevant.