Financial Markets Law Committee ("FMLC")

Joint Meeting of the Brexit Advisory Group and Infrastructure Scoping Forum

Meeting Date: Thursday 10 September 2020

Meeting Time: 10.00am to 11.00am

Virtual meeting

Attendees:

Venessa Parekh (Moderator)	FMLC Secretariat
Antony Beaves	Bank of England
Gregg Beechey	Fried, Frank, Harris, Shriver & Jacobson (London) LLP
Tom Callaby	CMS Cameron McKenna Nabarro Olswang LLP
Damian Carolan	Allen & Overy LLP
Thomas Donegan	Shearman & Sterling LLP
Paul Double	City of London Corporation
Emma Dwyer	Allen & Overy LLP
Kate Gibbons	Clifford Chance LLP
Jonathan Gilmour	Travers Smith LLP
Katy Hyams	The London Metal Exchange
Will Ingram	
Mark Kalderon	Freshfields Bruckhaus Deringer LLP
Vanessa Knapp	
Iona Levine	Minerva Chambers
Dorothy Livingston	Herbert Smith Freehills LLP
Anne MacPherson	Gibson Dunn & Crutcher LLP
Ian Mathers	
Hamish Patrick	Shepherd and Wedderburn LLP
Rob Price	Bank of England
Marke Raines	Raines & Co
Nathan Renyard	Cboe Europe
Andrew Seager	Taylor Wessing LLP
Michael Sholem	Cadwalader, Wickersham & Taft LLP
Mitja Siraj	FIA

Julia Smithers Excell	White & Case LLP
Ferdisha Snagg	Cleary Gottlieb Steen & Hamilton LLP
Arun Srivastava	Paul Hastings LLP
Peter Werner	International Swaps and Derivatives Association
Chhavi Sinha	FMLC Secretariat
Katja Trela-Larsen	FMLC Secretariat

Minutes:

1 Introduction

1.1. Ms Parekh opened the meeting and introduced the speakers.

2. Significance of the E.U.'s intention to adopt a CCP "time limited" equivalence decision (Thomas Donegan)

2.1. Mr Donegan provided an overview of the significance of the E.U.'s intention to adopt a "time limited" equivalence decision for Central Counterparties ("**CCPs**"). He explained that, although the U.K. has a temporary regime in place for E.U. CCPs to operate in the U.K. post-Brexit, there is no such regime in the E.U. for U.K. CCPs. He also noted that, pursuant to the application of Regulation 2019/2099/EU on the procedures and authorities involved for the authorisation of central counterparties and requirements for the recognition of third-country central counterparties ("**EMIR 2.2**"), it will not be possible for a Third Country CCP to provide clearing services to clearing members or trading venues in the E.U. unless the Third Country regime has been deemed "equivalent" by the European Commission and the CCP itself is subject to an equivalency decision.

2.2. Mr Donegan explained that the motivation behind the E.U.'s decision was to address risks to financial stability and E.U. monetary policy if E.U. counterparties could not clear through U.K. CCPs. On previously proposed dates for Brexit which have come and gone, the European Commission had adopted a similar approach under Commission Implementing Decision (EU) 2018/2031 (as amended) determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the United Kingdom of Great Britain and Northern Ireland is equivalent (the "**2018 Equivalence Implementing Decision**"). Mr Donegan noted that the 2018 Equivalence Implementing Decision would have applied from the date following the day the U.K. left the E.U. (31 January 2020), unless a withdrawal agreement between the U.K. and the E.U. had been ratified. The 2018 Equivalence Implementing Decision will not be applicable now, both

because the U.K. entered into a Brexit transition period after Exit Day, and because EMIR 2.2 provides for a different equivalence process.

2.3. Mr Donegan stated that, as per E.U. Commission's Communication dated 9th July 2020, it is considering the adoption of a time-limited equivalence. However, no indication of the "time limit" or text had been provided.[1] He noted that an equivalence decision must be agreed by the end of September 2020 to ensure U.K. CCPs don't need to start "off boarding" E.U. clearing members and trading venues. This difficulty is understood to be most of concern to LCH as a clearing house, as it is understood to have a three months' notice period to terminate its contract with E.U. based clearing members, which means if an equivalence decision is not reached by September, it will face a difficult decision.

2.4. Mr Donegan pointed out that, even with a CCP equivalence decision, exchange-traded derivatives traded on a U.K. exchange would still become over-the-counter trades ("**OTC**") for the purposes of Regulation (EU) No 648/2012 on over-the-counter derivatives, central counterparties and trade repositories ("**EMIR**"), unless there is also an equivalence decision for the U.K. exchanges under Regulation (EU) No 600/2014 on markets in financial instruments ("**MiFIR"**). There is no certainty in relation to such an equivalence decision.

2.5. Mr Donegan noted that the designation of CCPs in different tiers under EMIR 2.2 requires ESMA to assess whether a Third Country CCP's recognition application is complete within thirty days of receiving it. Thereafter, ESMA must inform the CCP whether it is a Tier 1 or Tier 2 CCP. Before making a determination as to a CCP's tier, ESMA must consult the European Systemic Risk Board (the "**ESRB"**) and central banks of issue. The assessment must take into account the criteria in EMIR and a delegated regulation containing technical specifications which will be published in the future. Mr Donegan provided an overview of this process and opined that this process was not designed well to address the timing issues arising from a member state exiting the EU. There remains a high degree of confusion even in the event a positive equivalence decision is granted for U.K. CCPs. The process under EMIR 2.2 is complicated as it involves making a preliminary decision as to the CCP's tier and a determination of varying compliance requirements. There is a fairly long list of requirements that U.K. CCPs will have to meet. Mr Donegan noted that there is considerable uncertainty around how the equivalence determination will work and the relevant timing of this as opposed to the tiering process and the assessment of comparability.

3. EU CCPs – the U.K. position (Emma Dwyer)

[1] European Commission: COM(2020) 324 final, Brussels, 9.7.2020; Communication on getting ready for changes Communication on readiness at the end of the transition period between the European Union and the United Kingdom

3.1. Ms Dwyer explained that the U.K. position on the CCP regime is clearer and simpler. For the E.U. CCPs to be recognised in the U.K., they need to satisfy U.K.'s transitional arrangements for Third Country CCPs, which will include the E.U. CCPs after Brexit. Ms Dwyer highlighted that in the U.K. there are three main statutory instruments dealing with CCPs. These are: The Central Counterparties (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018 ("**CCP SI 2018**"); The Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2019 ("**U.K. Emir SI 2019**") and; The Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2020 ("**U.K. Emir 2.2 SI 2020**"). The principal U.K. regulator for CCPs is the BoE. She noted that Part V of CCP SI 2018 revokes all existing E.U. recognition decisions for Third Country CCPs which are, therefore, not "onshored" in the U.K. E.U. CCPs currently authorised under EMIR will not be automatically authorised in the U.K. but will be treated as Third Country CCPs. Ms Dwyer explained that the transitional provisions bridge the gap for Third Country CCPs from the end of the transition period to real recognition.

3.2. Part VI of the CCP SI 2018 prescribes two processes for recognition: deemed recognition and temporary recognition. Deemed recognition is U.K.'s equivalent of the recognition procedure under EMIR that allows CCPs to apply for recognition before the end of transition period. In order to get recognized, a number of conditions need to be satisfied. These include an equivalence determination by HM Treasury. Following recognition, cooperation arrangements need to be put into place. Ms Dwyer stated that there is currently less transparency around whether any third Country CCP has applied for recognition under this procedure. Moving on to the second recognition procedure, Ms Dwyer pointed that temporary deemed recognition allows CCPs already authorised or recognised under EMIR to be recognised in the U.K. for three years, provided they inform the BoE (before the end of transition period) of their intention to provide services in the U.K. This recognition under Article 25 of EMIR can either be extended or be withdrawn by the BoE. There is a list published by the BoE of CCPs hoping to use this process.

4. Updates on CCP recovery and resolution (Ferdisha Snagg)

4.1. Ms Snagg provided an update on E.U.'s new legislative proposal on CCP recovery and resolution. She explained that to address the challenges posed by the growing importance of CCPs, and the potential risks for financial stability if a CCP were to fail, the European Commission had adopted a legislative proposal on CCP recovery and resolution; a proposal for a Regulation on a framework for the recovery and resolution of central counterparties (the "**Proposed Regulations**").[2] The aim

[2] European Commission: COM/2016/0856 final - 2016/0365 (COD) proposal for a Regulation on a framework for the recovery and resolution of central counterparties

of the proposal is to ensure that both CCPs and national authorities in the E.U. have the means to act decisively in a crisis. The new rules will ensure that CCPs' critical functions are preserved while maintaining financial stability and helping to avoid the costs associated with the restructuring and the resolution of failing CCPs from falling on taxpayers.

4.2. Ms Snagg noted that the legislative process to reach a final agreement on recovery and resolution has been long. She explained that the legislative process started in November 2016 and the Council and Parliament reached agreement in June 2020. Ms Snagg emphasised that this agreement is a significant step in the post-crisis derivative reform to strengthen the recovery and resolution regime. She further noted that the Proposed Regulations seek to ensure that CCPs can recover from financial distress caused by a default of a clearing member (or multiple clearing members) or by non-default losses from treasury losses, cyber-attack, operational failures and other sources. The Proposed Regulations also have a level playing field objective to enable CCPs to take advantage of single market freedoms. She highlighted that the Proposed Regulations take a similar approach to that of Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms **("BRRD"),** but with necessary differences to account for the different business models of CCPs and banks. For instance, under the Proposed Regulation, CCPs have to submit recovery plans to resolution authorities who then have to produce resolution plans. The supervisory authorities are also given early intervention powers, by which they may, among other things, require CCPs to implement recovery plans or force the directors to resign. The national authorities will have the possibility to resort to resolution tools. These include the termination of some or all contracts between the CCP in resolution and defaulting or non-defaulting clearing members, variation margin gains haircutting, a cash-call to clearing members (up to twice the amount equivalent to their contribution to the CCP's default fund), the write-down of CCP capital, the sale of the CCP or parts of its business or the creation of a bridge CCP.

4.3. Ms Snagg pointed that the Proposed Regulation includes certain extraneous points—for example, a provision clarifying that contracts which were entered into before the application of clearing and margin requirements to OTC derivative transactions will not become subject to these requirements when those contracts are amended for the purpose of implementing interest rate benchmark reforms. Members discussed the implications of Brexit for the Proposed Regulations. Ms Snagg explained that the Proposed Regulations will not be automatically retained in the UK because it will come into effect after the end of the Brexit transition period. HM Treasury will eventually decide whether the U.K. will adopt the Proposed Regulations. Ms Snagg added that the Proposed Regulations had been mentioned in The Financial Services (Implementation of Legislation) Bill which would have allowed HM Treasury to on-shore the legislation but the Bill and the Proposed Regulations have not been mentioned in recent policy updates and it is uncertain whether it will be included in Financial Services Bill. Ms Snagg further illustrated that the U.K. already has a

CCP resolution framework in the Banking Act 2009; however, the Proposed Regulations have additional tools compared to the Banking Act and therefore the UK might develop its own framework in the future. There is no clarity about whether the U.K. will align with the E.U.'s regime or simply comply with other international standards. Ms Snagg expressed the view that a divergence in approach between the E.U. and the U.K. on CCP recovery and resolution should not be as practically important as issues concerning CCP market access or a lack of cooperation/mutual recognition in matters such as clearing member resolution or settlement finality.

4.4. Attendees then discussed the possible classification of U.K. CCPs in a tier 2 category which could be considered systematically important. Members observed that political considerations may impact such a decision.

5. Any other business

5.1. No other business was raised.