PARLIAMENTARY DEBATES

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OFFICIAL REPORT

Fourth Delegated Legislation Committee

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

DRAFT TRADE REPOSITORIES (AMENDMENT AND TRANSITIONAL PROVISION) (EU EXIT) REGULATIONS 2018

Tuesday 4 December 2018

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not later than

Saturday 8 December 2018

The Committee consisted of the following Members:

Chair: Mr Nigel Evans

† Brown, Lyn *(West Ham)* (Lab)
Coaker, Vernon *(Gedling)* (Lab)
† Donelan, Michelle *(Chippenham)* (Con)
† Elmore, Chris *(Ogmore)* (Lab)
† Glen, John *(Economic Secretary to the Treasury)*
Kyle, Peter *(Hove)* (Lab)
† Lopez, Julia *(Hornchurch and Upminster)* (Con)
† Mercer, Johnny *(Plymouth, Moor View)* (Con)
† Merriman, Huw *(Bexhill and Battle)* (Con)
† Prisk, Mr Mark *(Hertford and Stortford)* (Con)
† Scully, Paul *(Sutton and Cheam)* (Con)
† Shah, Naz *(Bradford West)* (Lab)
† Skidmore, Chris *(Kingswood)* (Con)
Streeting, Wes *(Ilford North)* (Lab)
† Thewliss, Alison *(Glasgow Central)* (SNP)
† Tredinnick, David *(Bosworth)* (Con)
† Walker, Thelma *(Colne Valley)* (Lab)

Peter Stam, *Committee Clerk*

† attended the Committee

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Tuesday 4 December 2018

[Mr Nigel Evans *in the Chair*]

Draft Central Securities Depositories (Amendment) (EU Exit) Regulations 2018

2.30 pm

The Economic Secretary to the Treasury (John Glen): I beg to move,

That the Committee has considered the draft Central Securities Depositories (Amendment) (EU Exit) Regulations 2018.

The Chair: With this it will be convenient to consider the draft Trade Repositories (Amendment and Transitional Provision) (EU Exit) Regulations 2018.

John Glen: It is a pleasure to serve under your chairmanship, Mr Evans. The two statutory instruments before the Committee, which were debated in the House of Lords on Wednesday 28 November, form part of our contingency planning for a potential no-deal EU withdrawal scenario. They are two of approximately 60 SIs that we are laying under the European Union (Withdrawal) Act 2018 to ensure that the UK retains a fully functioning legislative and regulatory regime for the financial services sector after our withdrawal from the EU in March 2019.

Last December, the Treasury pledged to transfer functions and powers in relation to trade repositories and central securities depositories to the Financial Conduct Authority and the Bank of England respectively, thus enabling the regulators to manage any cliff-edge risks arising from a no-deal scenario and to ensure an orderly exit from the EU. The statutory instruments deliver on those commitments.

Trade repositories and central securities depositories provide essential services to UK customers under EU regulation. Should the UK leave the EU without a deal or an implementation period, they would be unable to provide services to UK firms until they had the appropriate permissions under the UK's domestic regimes, given that the UK would be outside the single market for financial services. The SIs therefore seek to ensure that there will continue to be a functioning regulatory regime to mitigate any risk of disruption to the provision of services in the event of a no-deal scenario.

Let me first discuss the draft Central Securities Depositories (Amendment) (EU Exit) Regulations. A central securities depository is an element of financial market infrastructure that keeps a record of who owns individual securities such as bonds or shares. Central securities depositories carry out three core functions: the registration of share ownership, trade settlement, and the maintenance of obligations arising from owning a security. Central securities depositories are governed by the central securities depositories regulation, which created a common authorisation, supervision and regulatory framework for central securities depositories across the EU.

The failure to maintain access to the UK for non-UK central securities depositories would introduce unnecessary risk to any UK firm using those services and would potentially cut off access to central financial markets. The draft regulations will therefore introduce a UK transitional regime that will allow both UK and non-UK central securities depositories to continue to provide services in the UK after exit next March.

To make use of the UK transitional regime, the draft regulations will also introduce a requirement for non-UK central securities depositories to notify the Bank of England, before exit day, of their intention to provide services in the UK after exit from the EU. The Bank of England has sent letters to non-UK central securities depositories—10 of them, I think—to set out the notification process. The draft regulations will introduce measures to mitigate those risks and ensure a smooth continuation of the provision of services by central securities depositories to the UK.

The draft regulations will transfer the various functions and powers currently held by EU bodies to the appropriate UK authorities. After exit, the powers that are currently held by the European Securities and Markets Authority in the EU to recognise non-UK central securities depositories will be transferred to the Bank of England. The European Commission's powers to make equivalence decisions are being transferred to the Treasury. This is a process of reviewing another country's regulatory framework to determine whether it is equivalent in outcome to one's own. Once the Treasury has deemed a country equivalent, the Bank of England can recognise central securities depositories within that country. This will allow such central securities depositories to provide services to UK firms in compliance with the UK regime.

I now turn to the draft Trade Repositories (Amendment and Transitional Provision) (EU Exit) Regulations. Trade repositories centrally collect and maintain data on derivative transactions. Derivatives are financial instruments that can be used to hedge against risks such as interest rate fluctuations or asset price volatility. The European market infrastructure regulation requires all data and information on European derivative transactions to be reported to trade repositories that are registered with or recognised by ESMA; this is known as the EMIR reporting obligation. If trade repositories are unable to provide services to UK firms post exit, those UK firms will be unable to fulfil their reporting obligation under the UK's regime, resulting in the UK regulators losing access to the data necessary for monitoring financial stability risks to the UK market.

The draft regulations will introduce measures to mitigate that risk, ensuring a smooth continuation of services from trade repositories to UK firms. First, they will establish a framework in the UK for the registration of UK trade repositories, while maintaining the same regulatory criteria for new UK trade repository applicants. To achieve that, ESMA functions relating to the registration of trade repositories will be transferred to the Financial Conduct Authority, including the mandate to make technical standards specifying the information to be provided by trade repository applicants. The FCA currently supervises UK firms subject to existing EU reporting obligations and is therefore familiar with the reporting requirements under EMIR, so it is the most appropriate UK authority to take on that role.

Secondly, the draft regulations will provide powers to the FCA to consider applications ahead of exit day so that a trade repository can provide services in the UK as soon as possible after exit. Thirdly, they will establish a temporary registration regime for eligible trade repositories that will allow them to continue to provide services to the UK by setting up new UK entities. This provides temporary registration for a period of three years to UK trade repositories that are part of a group that contains an ESMA-registered trade repository. The purpose is to allow additional time for those trade repositories' applications for permanent registration to be considered by the FCA and ensure continuity of services to UK firms. To enter the temporary regime, an eligible trade repository must, ahead of exit day, submit an application to the FCA for registration and set up a new legal entity in the UK.

Finally, the draft regulations will create a conversion regime whereby UK trade repositories that currently have ESMA authorisation are deemed to be registered by the FCA from exit day. To enter the regime ahead of exit day, a UK trade repository must notify the FCA of its intention to be registered. The conversion regime will ensure the smooth continuity of services from UK trade repositories to UK firms.

The Treasury has worked very closely with UK financial regulators and industry bodies to draft the statutory instruments. To ensure full transparency with Parliament, industry and the public ahead of laying the instruments, the Treasury published the trade repositories regulations in draft on 5 October 2018 and the central securities depositories regulations in draft on 22 October 2018, with an accompanying explanatory policy note for each. The regulators and the industry have generally been supportive of the policy decisions in the SIs, both of which are essential to ensuring that the UK retains a fully functioning legal regime both for trade repositories and for central securities depositories in the event of a no-deal scenario. The relevant UK regulators are also equipped to manage any cliff-edge risks. No matter what the outcome of the exit negotiations, UK businesses and customers who use trade repositories and central securities depositories can therefore be confident that they will continue to operate and provide services in the UK.

I hope colleagues from all parties will join me in supporting the draft regulations. I commend them to the Committee.

The Chair: Before I call the shadow Minister, let me inform the Committee that if there is a Division in the House, I will suspend our sitting for 15 minutes so that hon. Members can vote.

2.39 pm

Lyn Brown (West Ham) (Lab): It is an absolute pleasure to serve under your chairmanship, Mr Evans.

As we know, the regulations before us are two of a large number of statutory instruments relating to preparations for a potential no-deal Brexit. We expect around 70 to have been tabled by February. With this process, we have effectively begun to construct the bare bones of a functioning regime for financial regulation post Brexit.

Labour has consistently advocated for consolidated legislation on financial regulations. Since 2010, we have been faced with confusing, piecemeal legislation. There were financial regulation Acts in 2012, 2013, 2014 and 2015, and there have been more since—reams of reams of detailed amendments to legislation that was already complicated. On top of those Acts, Delegated Legislation Committees like this have attempted to scrutinise the many pieces of secondary legislation that have been needed to correct technical errors.

Put simply, we are concerned that the process for these Brexit regulations is not accessible or transparent. Not only does that make our role more difficult; it raises questions as to how stable the regulations will be if they do need to be used in respect of the industry itself or the wider public. My colleagues who are normally in this place, because I am not one of the economists in my team, have been reassured by the Government that these measures will not come into force should a deal be agreed before 29 March, but many of these powers could be applied whatever happened with Brexit. Which provisions will be revoked or substantially modified if, for example, we go into an implementation phase and no deal has, rightly, been ruled out as a possibility?

Before I ask my other questions, I want to make it clear why I think the regulations are important. The global financial crisis a decade ago taught us that the trading of derivatives and other securities needed to be better regulated within a transparent framework, and with robust infrastructure to monitor and enforce compliance. During the crisis, there was behind-the-scenes, over-the-counter buying and selling of complicated financial contracts, introducing risks that regulators and financial firms themselves could not properly assess or manage. There was no requirement to keep proper accessible records in the midst of that terrible crisis, and regulators could not always know who had bought which derivative and from whom. That meant that they could not know which banks or other financial institutions were exposed to bad loans or wrongly priced assets, gumming up the works of the financial system, and which were close to going under.

That is why, in the immediate aftermath of the crisis, it became a priority of the G20 in 2009 to move the regulation of over-the-counter derivatives to a regulated clearing framework. That change was put in place across the EU by the European market infrastructure regulation, which is implemented by the European Securities and Markets Authority. Having a robust, transparent infrastructure for derivatives trading imposes compliance requirements on firms across the EU, but it does help to protect us from a repetition of the events of 2008—we hope.

Colleagues will be aware that the draft Central Securities Depositories (Amendment) (EU exit) Regulations 2018 will make technical changes to ensure that the UK still has functioning regulations for central securities depositories, or CSDs, in the event of no deal. The regulations will transfer the power to make equivalence decisions from the European Commission to the Treasury. They will transfer powers from ESMA to the Bank of England, enabling the central Bank to recognise third-country CSDs after Brexit. They also make amendments to the transitional regime so that third-country CSDs can continue to provide services relating to the UK after exit.

The draft Trade Repositories (Amendment and Transitional Provision) (EU Exit) Regulations 2018 are intended to ensure that the UK's legal framework for the reporting of derivatives trades to trade repositories

[Lyn Brown]

continues to operate effectively after Brexit. Of course, we support the general aim of improving the transparency and predictability of the settlement of securities transactions. However, I do have some specific questions.

The explanatory memorandum for the draft central securities depositories regulations says that they aim only to ensure that the UK's framework will continue "to operate effectively". Will the Minister clarify whether any departure at all from EU rules is envisaged, however small? The Treasury website's guidance on those regulations states that an application before exit

"will be subject to existing UK law…while that application is being considered."

Will the Minister elaborate on whether there is any difference between the UK law that applies to applications before exit and the onshored regulation, once firms switch to it?

Similarly, the transfer of regulatory powers does not tell us anything about how UK-based companies will be affected in their future relationships with other countries' financial sectors. How will any decisions about third-country equivalence be taken in situations where in the past there was a joint decision by European and other authorities? In previous SIs, equivalence decisions have been transferred to the Treasury, not to the Bank of England. Will the Minister elaborate on why in this case it has been decided to transfer them to the Bank of England instead? How and why was the decision reached? Was it consulted on?

Our strongest commitment, as with all no-deal SIs, is to ensuring that such amendments to our regulations need never be used. We hope that they never will be, because a no-deal scenario is something that no responsible Government would allow to happen.

On the broader question of financial regulation, Labour will take measures to ensure that there is public faith in the financial and investment system. We will not repeat the light-touch regulation mistakes of the past. We have commissioned independent experts to report on how the regulatory system should be reformed to ensure that the kind of behaviour that caused such terrible damage during and before the financial crisis can never happen again. We know that people and society want and need banks in which they can safely deposit their money, that lend responsibly and that provide credit to finance investment across the whole country. All I can say is that I wish we were discussing how to do that, rather than these no-deal Brexit preparations.

2.47 pm

Alison Thewliss (Glasgow Central) (SNP): It is a pleasure to see you in the Chair, Mr Evans, and to join the Committee for another session as we hurtle towards EU exit. As I have said in other such debates, it is not something that the Scottish National party wanted to see or that voters supported in Scotland, where 62% voted to remain. However, I will play my part in these things and call for the Government to answer some questions.

As always, I have concerns about a potential reduction in regulatory standards. I seek assurances from the Minister that that will not occur and that at the very minimum we will keep to the standards outlined in current EU legislation. We know the long-term impact that the financial crash has had on our economy; I do not think that anyone would argue that lack of regulation was not a major driver of it. We cannot veer back towards that situation; that would be terrible for all our constituents throughout the UK.

Let me address the central securities depositories regulations first. I note from the impact assessment that the familiarisation cost is £400 per firm—£4,400 to all firms affected. That is a further burden to business from making these changes for Brexit. I am sure that nobody told businesses at the time of the referendum that they would incur such costs as a result of Brexit; it is one of those things that is hidden in the detail.

The Minister mentioned Sir Jon Cunliffe's letter of 25 October to CSDs. Can he tell us what reply he has received from them? I appreciate that the number of CSDs is rather small, but it is not unreasonable to expect some response. It would be good to have a little more detail about what they are saying about the draft regulations.

I note that there is nothing in the impact assessment about monetised non-familiarisation costs of the central securities depositories regulations, whereas that information is provided about the trade repositories regulations. Is that because the costs are not known, or because there are no costs, as the central securities depositories regulations do not have an impact in the same way?

On trade repositories, will the Minister give us more information about the UK'S future relationship with ESMA? Clearly, ESMA will continue to function, make regulations and do things. How much notification will there be of obligations to apply the rules set up so that we continue to have a relationship? Is there any indication of what formal agreements or other types of arrangements might be put in place?

I note that there is a draft registration form on the FCA website, as well as a consultation on fees, which runs until January for the trade repositories. Will the Minister give more detail about that process? Does a draft registration form become a formal registration form at the point that the UK wishes to leave the EU, or before then? What is the process? Is there much point in those trade repositories that wish to fill out that form doing so in draft if they can do so in a permanent form? Will they have to do the paperwork twice? Will the Minister indicate what level of fees the Government feel are reasonable for the process? If people are asked how much they would like to pay, I am sure that most people will say that they would like to pay no fee, but the Government might have a different idea.

The impact assessment quotes familiarisation costs of the trade repositories regulations as £150 per firm, which is £1,200 for all impacted firms, as there are only eight. However, the wider impact of the monetised non-familiarisation costs to business, as outlined on page 47 of the impact assessment, is quite different, as they could run to £10,000 to £15,000 per trade repository—a total of £80,000 to £120,000. There would also be a cost of £5,000 per firm accessing trade repositories, with an unknown total cost, because it is about changing IT systems and internal processes. If we read the start rather than the end of the document, we get quite a different picture of the impact of the regulations.

The impact assessment states, at the bottom of page 47, that trade repositories are

"currently regulated by ESMA, so the UK regulators do not have direct access to information relating to clients of trade repositories."

We therefore do not know how many will be affected. Will the Minister tell us a wee bit more about what conversations he has had with ESMA? Is ESMA unable or unwilling to give him that information? Has information been requested? It is difficult to get an idea of the total impact if we do not know how many are currently regulated, so we should be able to access that information.

The Minister will expect me to raise my usual concerns that both sets of regulations put more burden on the FCA, the Bank of England and other regulators, and that we do not have the specialists to deal with it. Registering is a new thing, so will the relevant functions and IT be in place in good time to allow all that to happen?

2.53 pm

John Glen: I thank the hon. Members for West Ham and for Glasgow Central for their points, and I will endeavour to answer all of them. I recognise that some of the scenarios are obviously not desirable, and I echo their comments about that. We are seeking a deal, and the framework of the deal for financial services would give us provision for early equivalence decisions before the end of the implementation period, and we hope that will happen. We believe that the regulations are necessary to ensure that the UK retains a fully functioning legal regime for the trade repositories and central securities depositories in the event of a no-deal scenario. I also want to make the point, which applies in response to both hon. Ladies' comments, that the Government do not, in any eventuality, see the UK financial services sector trading on some deregulatory arbitrage basis, where we somehow remove ourselves from the context in which we have been so intimately involved within the EU with respect to regulations. The hon. Member for West Ham made reference to the Pittsburgh agreement in 2009 to improve transparency, and we stand by that. A holistic review was undertaken following the crisis and the ESMA rules came into effect to try to address that.

On the point about how stable the regulations on central securities depositories will be when needed, we have engaged extensively with the regulators and with industry, and we are confident that we will ensure a stable and functioning regime at the point of exit. With respect to what happens if there is a deal, the withdrawal agreement Bill will include provision to delay, amend or revoke statutory instruments made under the European Union (Withdrawal) Act 2018, so we would make a decision based on what was appropriate at that time.

The hon. Lady asked about the differences between the transition regime for CSDs and full authorisation or recognition under CSDR. While a CSD is within the transitional regime, it will be subject to the recognised clearing house regime in part 18 of the Financial Services and Markets Act 2000. Other legislation, such as the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001, is also relevant. Recognised clearing houses must be recognised as part of the Bank of England, which gives an exemption from the general prohibition under FSMA IV regulated activity. A recognised clearing house may provide clearing services in the UK.

Once a UK CSD has been authorised, or a non-UK CSD has been recognised, the onshore CSDR regime will apply to it. That consists of the EU CSDR and the UK's 2014 and 2017 regulations that implement it, and CSDs are given a separate exemption in section 285 of FSMA. As the hon. Lady pointed out at the start, the regulation is complicated by the way that those markets function. That regime is more extensive than the recognised clearing house regime and contains more detailed requirements about the operation and supervision of CSDs.

The hon. Lady also asked whether there would be any departures from EU law. The legislation is drafted using powers under the European Union (Withdrawal) Act 2018, so there is no policy innovation or deviation. That Act does not allow such policy changes, except where necessary to address deficiencies in language or such like. No changes are made to the regulatory requirements on CSDs.

The hon. Lady asked about the appropriateness of the Bank of England recognising non-UK CSDs. The Bank of England is obviously the UK regulator responsible for the authorisation and supervision of UK CSDs. It has a process in place for the recognition of UK CSDs and therefore has the most relevant experience for recognising non-UK CSDs. That sort of pattern has been followed throughout the construction, engagement and laying of these statutory instruments, so where the Commission is appropriate for making equivalence decisions, that comes to the Treasury, because we are equivalent, and the same with ESMA and the Bank of England.

Lyn Brown: There is one bit that the Minister has not touched on, which is third-country equivalence.

John Glen: The regime that we would be onshoring for the future recognition of third countries would be a matter for us to consider, on the same basis that we would be onshoring EU entities that would have a new legal entity in the UK. It will be the same process, but one that we would essentially have to do domestically, rather than relying on the ESMA framework.

I now turn to the points of the hon. Member for Glasgow Central. I acknowledge the recurrent but appropriately made comments about her party's position. All I can say is that I have tried to conduct this in as professional a manner as possible. The regulators have the resources available. They have a supervisory framework and, through the levy, they have the ability to make the appropriate resources available.

The hon. Lady asked about the temporary registration regime, which is intended to allow existing EU trade repositories to continue to provide services to the UK. It allows the new UK legal entities, which are part of an ESMA-authorised group, to submit an application. In terms of the process for that application, she mentioned the drafts on the site. I cannot give her the responses to the letter of 25 October, but I undertake to write to her on that. I need to speak to the regulators to understand where they are with that.

The hon. Lady also made a point about the degree of engagement that we have had with the EU. We have had a wide range of discussions with our EU counterparts—I have not personally, but my officials have—on matters relating to our withdrawal from the EU and this matter.

The UK Government and regulatory authorities will continue to do everything we can to ensure a smooth adjustment for firms and customers on both sides. Unfortunately, as with many of these matters, we cannot determine the EU's response. That has been a challenge over this

[John Glen]

period. It is inevitable that, in a no-deal scenario, hostility will break out. It is in the interests of all market participants, regulator-to-regulator, Government-to-Government, to continue to work closely together, because that is in the interest of stability.

I believe that has addressed most, if not all, of the points raised.

Alison Thewliss: On the point about not knowing the exact number of firms affected, I draw the Minister's attention to paragraph 124 on page 32 of the impact assessment, which says:

"As the volume of firms affected is so large, and both financial counterparties and non-financial counterparties are affected by the reporting obligation, it is difficult to provide an estimate of the number of firms affected."

Will he tell me more about what can be done to raise awareness among the firms that may be caught up in this? If they do not know about it, they will not know about their obligations to comply.

John Glen: The existing reporting obligations for both statutory instruments are enduring and have been established for a long time. The issue of reporting into a different legal entity would come to pass following the enablement and the enacting of this regime.

The hon. Lady referred to the different parts of the impact assessment and the wider cost of familiarisation. She is absolutely right to draw attention to the undesirability of this additional cost and expense. That is why we do not advocate a no-deal scenario. I am not in a position to give her any more information, because I do not possess it. It will be incumbent on the regulator to send out timely information updates on what will be required. There is no meaningful change in what a market participant will need to do, in terms of the information they will need to share.

I hope the Committee has found this afternoon's sitting informative and that it will support these regulations.

Question put and agreed to.

Resolved,

That the Committee has considered the draft Central Securities Depositories (Amendment) (EU Exit) Regulations 2018.

DRAFT TRADE REPOSITORIES (AMENDMENT AND TRANSITIONAL PROVISION) (EU EXIT) REGULATIONS 2018.

Resolved,

That the Committee has considered the draft Trade Repositories (Amendment and Transitional Provision) (EU Exit) Regulations 2018. —*(John Glen.)*

3.3 pm

Committee rose.