European Scrutiny Committee

House of Commons London SW1A 0AA
Tel (020) 7219 3292 Email escom@parliament.uk Website www.parliament.uk/escom

From: Sir William Cash MP

24 September 2020

John Glen MP
Economic Secretary to the Treasury
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

EU supervision of UK Central Counterparties (EMIR 2.2) (update)

Thank you for your Explanatory Memorandum of 27 July 2020 on the latest developments in the EU's implementation of new, stricter requirements for access by "third country" Central Counterparties (CCPs) into the EU market for derivatives trades under the amended European Markets Infrastructure Regulation (EMIR 2.2). We note that the European Commission has initiated the process for adopting a temporary equivalence decision for the UK under EMIR ahead of the end of the post-Brexit transition period, the timing of which appears to defer the full application of the new approach to "systemically important" UK CCPs until mid-2022.

As you will be aware, the Committee has followed the negotiations on the amendments under EMIR 2.2 with respect to the supervision of non-EU CCPs closely for over three years, given the clear implications for the British clearing industry – and therefore Europe's financial markets - when the UK leaves the Single Market at the end of the post-Brexit transition period. We remain concerned about the demands for regulatory alignment that the new Regulation implies in return for market access, as well as the explicit EU objective of increasing its domestic clearing capacity for derivatives at the expense of the UK.

Based on the final text of the Regulation and the Delegated Acts published by the European Commission in July this year, as well as the recent agreement of the separate new Regulation on the Recovery & Resolution of failing CCPs, we have some further questions for with respect to the impact of EMIR 2.2.

Supervisory cooperation between the Bank of England and ESMA

First, the Government of course consistently opposed the change to EMIR that now makes market access under equivalence dependent on a supervisory agreement between ESMA and the relevant non-EU regulator – like the Bank of England – which contains a commitment by the latter to "assure the effective enforcement" of supervisory decisions taken by the former.[1]

This, the Government itself has previously said, "could require a supervisor to enforce a decision [that] may conflict with its own domestic requirements and could increase financial stability risks in a stress scenario" and "become a barrier to market access in the future as third countries are very unlikely to bind their independent supervisors in this way". However, there is a lack of clarity as to how the Government intends to address this issue now that it is actively seeking an equivalence decision from the European Commission under EMIR. In particular, it appears that the new requirement on 'assurance' has already taken effect under EU law, and will therefore need to be resolved before UK CCPs can obtain permission from ESMA to operate in the EU under the forthcoming equivalence decision when the transition period ends. We note in this regard that your latest Memorandum makes no mention of any discussions that have been had with the EU on the precise meaning of "assure" in this context, to arrive at a mutually satisfactory solution that preserves the UK's regulatory autonomy in this sector, nor of the status of the ESMA-Bank of England Memorandum on CCPs concluded in early 2019 prior to the recent changes to EU law.

In light of this, it would be helpful if you could confirm whether this new requirement for a "third country" supervisor to "assure" ESMA's decisions will need to be addressed as part of a supervisory agreement between the UK and the EU before the end of the transition period, if UK CCPs are to be successful in obtaining ESMA recognition ahead of 1 January 2021. We would also be grateful if you could clarify, therefore, whether discussions are taking place between the UK and the EU on the practical implementation of this 'assurance' requirement (for example by means of a revision or replacement of the earlier Memorandum of Understanding); outline what the status of any such discussions is at present; and undertake to keep the Committee informed of the outcome of those discussions in due course so that Parliament can scrutinise the implications, if any, for the powers of the Bank of England.

Comparable compliance for "tier 2" non-EU CCPs

[1] New Article 25(7) of Regulation 648/2012.

Secondly, as you know, a range of stricter conditions will be introduced for systemically important ("tier 2") non-EU CCPs seeking to operate within the Single Market when the Commission's recent Delegated Acts supplementing the EMIR 2.2 Regulation take effect. Notably, they will have to demonstrate more granular compliance with specific provisions of EMIR relating for example to prudential, organisational and conduct requirements in order to obtain recognition from ESMA. One way of doing so is to meet a "comparable compliance" test under which their home jurisdiction's regulatory approach is assessed for its alignment with EMIR, above and beyond what was necessary to achieve equivalence in the first place.
In previous correspondence with the Committee, you referred to the "comparable compliance" provisions as a way of addressing the aforementioned issue relating to "assurance" of ESMA's supervisory decisions by the Bank of England. We take this to mean that, should the UK's regulatory approach continue to match EMIR closely, the EU could be assured that the Bank would take action in any event against "tier 2" CCPs with permission to operate in the EU under equivalence where ESMA would have expected it to do so. However, the UK would in fact need to meet the necessary conditions for ESMA to declare its regulatory framework as comparable to EMIR. That, in turn, implies a high degree of continued regulatory alignment with the relevant provisions of EU law.

In light of this, it would be helpful if you could clarify if the Government - as part of its engagement with the European Commission on equivalence – has made, or intends to make, any commitments with respect to alignment with or divergence from the provisions of EMIR relevant to comparable compliance, and explain how individual CCPs might demonstrate adherence with those provisions instead if ESMA rejects a request for comparable compliance with respect to the UK (for example due to regulatory divergence).

The EU's Recovery & Resolution Regulation for CCPs

Lastly, your officials have recently informed us of the adoption of a separate new EU Regulation on the recovery & resolution of failing Central Counterparties. While we await a formal update from you on the substance of those rules, it would be helpful if you could clarify if the substance of that new legislation will be, or is likely to be, taken into account by the European Commission and ESMA when they assess continued equivalence for CCPs based in non-EU jurisdictions under EMIR when this new Regulation has taken effect as a matter of EU law.

We look forward to receiving your response by 16 October, which we would also expect to provide information more generally about any developments in

the equivalence process under EMIR that may have taken place following your receipt of this letter.

I am copying this letter to Rt. Hon Mel Stride MP, Chair of the Treasury Committee and Gosia McBride, Clerk of that Committee; to Lord Kinnoull, Chair of the House of Lords EU Select Committee, and to Chris Johnson, that Committee's Clerk; to Maitreya Thakur and James Chandler at your Department; and to Les Saunders in the Cabinet Office.

CHAIR