

Financial Services Future Regulatory Framework Review: Central Counterparties and Central Securities Depositories

UK Finance response to consultation from HM Treasury

28 February 2022

Introduction

1. UK Finance is the collective voice for the banking and finance industry. Representing more than 300 firms, we act to enhance competitiveness, support customers and facilitate innovation. We welcome the opportunity to respond to HM Treasury's (HMT) consultation on the Bank of England's regulation of central counterparties (CCPs) and central securities depositories (CSDs).¹ Many of our members use UK-based CCPs and CSDs on a daily basis to clear and settle securities transactions.
2. As we stated in our response² to HMT's separate consultation on proposals for reform under its Financial Services Future Regulatory Framework (FRF) review,³ we continue to believe in the broad appropriateness of the existing UK model of regulation established by the Financial Services and Markets Act 2000 (FSMA),⁴ in which independent regulators act to advance objectives set for them by Parliament. Indeed, we have called for the "FSMA model" and accompanying FRF reforms to be extended to other areas of financial services regulation, beyond those for which the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) are responsible.
3. We therefore welcome HMT's proposal to extend the FSMA model to the regulation of CCPs and CSDs. Giving the Bank greater responsibility for setting regulatory standards in this area will allow for a more flexible and adaptive framework than is possible while the regulation of financial market infrastructures (FMIs) remains enshrined in retained EU law. UK-based CCPs and CSDs perform a vital function, not only for the UK's financial system and wider economy but also internationally. It is therefore crucial that the regulation governing them be sufficiently agile to adapt to future market conditions.

¹ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1046976/Final_version_FRF_for_CCPs_and_CSDs_consultation.pdf

² <https://www.ukfinance.org.uk/system/files/UK%20Finance%20response%20to%20FRF%20consultation%20on%20proposals%20for%20reform.pdf>

³ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1032075/FRF_Review_Consultation_2021_-_Final_.pdf

⁴ <https://www.legislation.gov.uk/ukpga/2000/8/contents>

4. Many of the proposed measures (particularly regarding transparency, accountability and stakeholder engagement) are identical to those proposed in HMT's separate FRF consultation. As we stated in our response, we broadly support these measures, subject to their detail. We equally support these proposals in the context of the Bank's regulation of CCPs and CSDs. Rather than restating our views in this response, we invite HMT to refer to our answers to the relevant questions in our response to the separate consultation.
5. In this response, we opine on the proposals that are specific to this area of regulation. We support the proposal to assign the Bank a primary objective of protecting financial stability and recognise that the nature of CCPs and CSDs means that a secondary competition objective is not appropriate in respect of their regulation. However, alternative measures are required to ensure sufficient regulatory attention is given to securing the ends to which competition is usually a means. In particular, we believe the Bank should be assigned a secondary objective to ensure that CCP and CSDs are operated and developed in a way that considers and promotes the interests of the wide range of businesses that use them.
6. Similarly, we support the intention behind the proposed secondary objective to facilitate innovation but believe this should not require the Bank to attempt to actively promote innovation as this would encounter the well documented risks associated with the public sector intervening to "pick winners." We also agree that a continued reputation for financial stability is key to the global success of UK CCPs and CSDs, and we therefore ask HMT to consider a secondary growth and competitiveness objective for the Bank, as it has proposed to assign to the FCA and the PRA in the separate FRF consultation.
7. Finally, while we support repealing relevant retained EU law to enable the Bank to introduce its own rules, we urge HMT to ensure that due consideration is given at all times to the potential impact of the Bank's regulation of CCPs and CSDs on the EU's recognition of the UK regimes as equivalent, as the withdrawal of the existing equivalence decisions could lead to restricted access for EU market participants to UK CCPs and CSDs. This would not be in the interests of firms and their customers in either the UK or the EU.
8. If you have any questions relating to this response, please contact Daniel Wraith, Manager, Strategic Policy, at daniel.wraith@ukfinance.org.uk.

Consultation questions

Question 1: Do you agree with the proposed set of statutory objectives and regulatory principles for the Bank, in its capacity as CCP and CSD regulator?

9. Under the FSMA model, a regulator's statutory objectives and the regulatory principles to which it must have regard when discharging its functions are of critical importance, given the significant discretion afforded to it in setting regulatory standards. If these are not correctly calibrated, the regulator could be left to make significant policy trade-offs that democratic accountability suggests the government and/or Parliament should make instead.
10. We agree with the proposal for the Bank's primary objective, in its regulation of CCPs and CSDs, to be to protect and enhance the stability of the financial system of the UK. As the consultation recognises, these FMIs are of systemic importance, and the primary aim of regulation should be to ensure that their activities do not pose undue risks to financial stability.

11. Moreover, we agree that, in advancing this objective, the Bank should consider the financial stability impact of UK CCPs and CSDs on other jurisdictions. As the consultation states, UK-based CCPs and CSDs serve market participants from around the world, and their actions, and the regulation to which they are subject, can therefore have ramifications for financial stability beyond the UK. The UK enjoys many benefits from being a global hub for these activities, and it is right that it should also assume a degree of responsibility for the risks that they pose beyond the UK. We agree that regulating UK CCPs and CSDs with appropriate and proportionate regard to financial stability in overseas jurisdictions will be mutually beneficial, given the significant interconnection between the UK and international financial systems.
12. We also support making explicit that the Bank must have regard to ensuring its regulation is not based on the nationality or location of the users of FMI services. This is entirely consistent with the government's Global Britain commitment to ensuring minimal barriers to international trade and cross-border activity.
13. As we set out in our response⁵ to HMT's phase-II FRF consultation,⁶ we strongly advocate effective competition as a well-established means of creating the right conditions for innovation and securing good outcomes for customers/users as regards price, quality and value for money. However, we recognise HMT's argument that a secondary competition objective would not be suitable for the Bank's regulation of CCPs and CSDs as their nature means that they are most effective when there is an intense concentration of activity at a single CCP or CSD. Absent a competition objective, the Bank must instead be assigned a clear mandate to promote the ends to which competition is usually a means. In particular:
 - we agree with HMT that, given the desirability of market concentration from a financial-stability standpoint, it is all the more important to ensure the fair, reasonable and equitable provision of services by CCPs and CSDs to their members. We therefore believe that the proposed regulatory principle to this effect should be upgraded to a secondary objective to "ensure that CCPs and CSDs are operated and developed in a way that considers and promotes the interests of all the businesses that use, or are likely to use, them." While the specifics of the objective itself would be different, this would be similar to the level of mandate accorded to the Payment Systems Regulator through its statutory objective "to ensure that payment systems are operated and developed in a way that takes account of, and promotes, the interests of those who use, or are likely to use, services provided by payment systems";⁷ and
 - we are generally of the view that the private sector is best placed to innovate and the public sector should not attempt to intervene to actively "pick winners." However, we believe the proposed secondary objective to facilitate innovation could be beneficial, provided its wording focuses on the need for the Bank not to create or maintain barriers to innovation by, for instance, entrenching specific business models or technologies. The current model of CCPs and CSDs, and the technologies they employ, are not the only potential means of safe and efficient clearing and settlement, and such a secondary objective should help ensure that the Bank's regulation in this area is

⁵ <https://www.ukfinance.org.uk/system/files/F2R2-phase-II-consultation-FINAL.pdf>

⁶ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1032075/FRF_Review_Consultation_2021_-_Final_.pdf

⁷ <https://www.legislation.gov.uk/ukpga/2013/33/section/52/enacted>

“technology neutral,” to the extent that this is compatible with advancing its primary financial-stability objective.

14. The consultation rightly notes that the international attractiveness of UK CCPs and CSDs owes strongly to their reputation for effectively managing risk and ensuring financial stability. Given the complementarity of financial stability and the global standing of UK CCPs and CSDs, we are sceptical of HMT’s conclusion that assigning the Bank a secondary objective to facilitate growth and competitiveness would not be appropriate. We strongly support HMT’s proposal, in its separate FRF consultation, to assign such an objective to both the FCA and the PRA across all areas of regulation for which they are responsible. We believe the arguments supporting that proposal are equally applicable to the regulation of CCPs and CSDs and fully compatible with the pursuit of deference arrangements, substituted compliance and mutual-recognition agreements, and we therefore ask HMT to reconsider its application in this context.
15. We broadly agree with the other proposed regulatory principles to which the Bank would be required to have regard in discharging its functions in this area. These are principles of good regulation, equally applicable to any area of financial services regulation. However, we believe that the wording of the consumer-responsibility principle should remain unaltered as we do not agree with HMT’s assessment that “it is specific types of financial services firms that use CCP or CSD services and not retail consumers.” In fact, some retail investors (e.g. those in listed securities) will rely on the existence of CSDs and, indeed, in some cases can actually hold an account with certain CSDs.
16. Finally, we support the proposal to give HMT a power to set activity-specific “have regards” and to require the Bank to make rules in relation to specific areas, subject to the safeguards for which we argued in respect of the proposal for analogous powers in the separate FRF consultation (see our answer to question 11).

Question 2: Do you agree with the proposed enhanced accountability mechanisms to HM Treasury and Parliament, as well as the proposed measures to increase transparency to external stakeholders

17. We strongly agree with the proposed approach to resolving the interaction between the Bank’s discretion to exercise its general rule-making power and the government’s overseas arrangements and agreements. The government is rightly ambitious in seeking maximum market access for UK-based firms in other jurisdictions, including by means of deference arrangements, substituted compliance, mutual-recognition agreements and provisions in free-trade agreements. Given the significance of regulation to these arrangements, it is entirely appropriate to require the Bank to consult HMT on the general anticipated impact of any proposed rules on them, including on the EU’s recognition of the UK’s regulation of CCPs and CSDs as equivalent to its own.
18. We broadly support the other proposed enhanced accountability mechanisms and measures to increase transparency to external stakeholders, just as we supported them in the separate FRF consultation. Rather than restate our detailed views in this response, we invite HMT to refer to our answers to the relevant questions in our response to that consultation.