

Post-Brexit Equivalence: Central Counterparties (CCPs)

CCPs play a crucial role managing risk in financial markets, which is critical for financial institutions and non-financial users of the markets. Since the financial crisis, the regulatory regime around them has been strengthened, with the objective of requiring markets to clear trades through CCPs that are authorised for that particular type of activity. London clearing houses currently handle the lion's share of the circa €735 trillion European derivatives market. In September 2020, the Commission deemed it necessary to grant time-limited equivalence so that EU financial institutions would have adequate time to reduce their exposure to UK market infrastructure beyond the end of the Brexit transition period.

Overview – UK Equivalence Decision

- On 9 November 2020, the Chancellor of the Exchequer announced that the UK would grant a package of equivalence decisions to the EEA States.
- The measures included the granting of equivalence to CCPs, subject to entry into a suitable co-operation arrangement between the Bank of England and the relevant national competent authority (NCA), and a CCP-specific recognition determination by the Bank of England.
- The equivalence decision does not prevent EEA CCPs from taking advantage of the Temporary Recognition Regime (TRR) and, until a recognition decision is taken, EEA CCPs who meet the requisite eligibility criteria may remain in the TRR, which is expected to last until December 2023 unless extended by HM Treasury.

Comparison

Decision	
The Central Counterparties (Equivalence) Regulations 2020	Commission Implementing Decision (EU) 2020/1308
Date of Expiry	
N/A	30 June 2022
Rationale for Equivalence	
To provide clarity and stability to industry, support well-regulated, open markets, and ensure UK and EEA clients' access to financial services and market liquidity	To counter risks to EU financial stability in light of the significant proportion of instruments cleared by UK CCPs
Relevant Supervisor of third-country CCPs	
Bank of England	ESMA
Caveats	
HMT may revoke the equivalence determination at any time	Can be unilaterally withdrawn at any time
Recognised CCPS to date	
None to date, but EEA CCPs who meet the relevant eligibility criteria remain in the Temporary Recognition Regime	LCH, ICE Clear Europe and LME Clear

Overview – EU Equivalence Decision

- On 21 September 2020, the Commission published the time-limited decision determining that the regulatory framework applicable to CCPs in the UK is equivalent to EMIR in the *Official Journal*.
- The decision will apply from 1 January 2021 until 30 June 2022.
- In September 2020, ESMA and BoE agreed a memorandum of understanding setting out the arrangements for co-operation on the monitoring and supervision of CCPs established in the UK.
- At the same time, ESMA adopted decisions to recognise three UK CCPs as third-country CCPs. The relevant CCPs are LME Clear Ltd, ICE Clear Ltd and LCH Ltd. These decisions will apply for as long as the equivalence decision remains in force.

Looking Ahead: How Likely is a Further Equivalence Decision in Favour of the UK?

- So far, the EU has adopted time-limited equivalence decisions in respect of the UK for financial stability reasons and there is no guarantee that a permanent deal will replace the temporary decision in respect of UK CCPs when it expires at the end of June 2022. Indeed, the recitals of the implementing decision make it clear that temporary equivalence was adopted "in order to give clearing members established in the Union the time to reduce their exposure to United Kingdom market infrastructure as well as CCPs established in the Union the time to develop further their capacity to clear relevant trades."
- EU firms should prepare for increased supervisory scrutiny of their exposures to UK CCPs, especially OTC derivative exposures denominated in Euro or other EU currencies.
- In early March 2021 in a speech to FIA, Inc.'s Boca International Futures Industry Conference, Mairead McGuinness reiterated that Brexit has "laid bare some of the vulnerabilities in our financial system linked to the dependence on third-country market infrastructures." Ms McGuinness went on to emphasise that the time-limited equivalence decision should not be considered a "waiting area" for EU market participants, but the time should be used to reduce their derivatives exposures to UK-based CCPs.
- She confirmed that in January the Commission established a working group alongside the ECB and other supervisory authorities to identify opportunities and challenges for transferring EU currency-denominated derivatives from the UK to the EU. The working group's recommendations are expected by the end of H1 2021 and will feed into future developments.

Impact for our Clients & Alternatives to Equivalence

- The framework is in place for FIs in the UK to access CCPs in the EEA following Brexit, *provided* that the Bank of England makes the necessary co-operation arrangements with the relevant NCAs and makes appropriate determinations in respect of the specific CCPs. Until these steps are taken, however, EEA CCPs may make use of the TRR.
- If the Commission does not replace the temporary equivalence decision with a long-term decision in respect of UK CCPs, then post 30 June 2022, any EEA FIs that still have derivative positions held in UK CCPs will be subject to an increase in capital requirements and UK CCPs will no longer be an option for satisfying EU clearing mandates.
- Absent long-term equivalence, the options for EEA FIs include:
 - i. trading out of positions in UK CCPs and opening new trades in other CCPs recognised by ESMA. This will require co-operative counterparties and the availability of equivalent contracts in the alternative CCP.
 - ii. moving all positions to a CCP authorised by ESMA. This option requires careful consideration of:
 - a. the laws applicable to all parties (CCPs, clearing members and clients),
 - b. the relevant authorisations of the receiving CCP to ensure that it is able to clear the contracts,
 - c. the operational readiness of the receiving CCP, including an assessment of levels of capital held by the CCP and its clearing members
- Either of the above options requires sufficient time to plan and execute.