

Consultation Paper
Levying fees for financial market infrastructure
supervision
August 2017



BANK OF ENGLAND



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Responses are requested by **6 October 2017**.

Please address any comments or enquiries to:

Joanna Bibby-Scullion
Bank of England
20 Moorgate
London
EC2R 6DA
Email: FMIfeedback@bankofengland.co.uk

Purpose

The purpose of this consultation paper (CP) is to seek views on the Bank of England's (the Bank) proposal to introduce a new funding structure for the supervision of financial market infrastructure (FMI).¹ The Bank has certain legal powers to levy fees on FMIs but, to date, has not exercised these.²

This CP seeks views on the broad approach proposed by the Bank. It puts forward an over-arching fee-levying model, explains the drivers for this proposal, notes the powers that we intend to utilise and highlights key aspects regarding the implementation of the approach. We would welcome feedback on all aspects of the proposal.

This CP is mainly of interest to FMIs currently supervised by the Bank. However it also includes proposals to levy a fee on any FMIs who may make certain applications to the Bank, such as for authorisation under the European Market Infrastructure Regulation (EMIR)³ in accordance with the Financial Services and Markets Act 2000 (FSMA) or to become a designated system under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (the Settlement Finality Regulations (SFR)).

The Bank will take account of feedback on this CP and, if the Bank decides to implement a fee levy for FMI supervision, there will be further consultation in due course on the detail of any fee-levying arrangements, with a

¹ For the purposes of this consultation, the term FMI refers to central securities depositories, central counterparties, and recognised payment systems.

² The power under the Banking Act 2009 to require operators of recognised payment system to pay fees requires the approval by HM Treasury of a scale of fees. The other fee charging powers exist without need for further legislation.

³ Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories

view to any new arrangements commencing in 2018.

This consultation closes on 6 October 2017. The Bank invites feedback on the proposals set out in this CP. Please address any comments or enquiries to FMIfeedback@bankofengland.co.uk.

Introduction

The Bank supervises FMIs with a forward looking, risk-based approach, '*...prioritising its supervisory effort based on its assessment of where risks to financial stability are greatest*'.

⁴ Within the Bank, the Financial Market Infrastructure Directorate (FMID) has responsibility for supervising FMIs. In order to undertake its supervisory activities effectively, FMID draws in specialist resource and expertise from other areas of the Bank including the Prudential Regulation Authority (PRA).

The Bank currently funds its supervision of FMIs through Cash Ratio Deposit revenue.⁵ This funding model was set out in the Bank's published approach to supervision when it assumed its new responsibilities for FMI supervision in 2013.⁶ In February 2017, the Bank's Independent Evaluation Office (IEO) published its evaluation of the Bank's approach to FMI supervision.⁷ The IEO's report considered, amongst other things, the approach to funding for FMI supervision.

⁴ See:

<http://www.bankofengland.co.uk/financialstability/Documents/fmi/fmisupervision.pdf>

⁵ Cash ratio deposits (CRDs) are non-interest bearing deposits lodged with the Bank by eligible institutions. The interest earned from the deposits is used by the Bank towards funding its operations. The CRD scheme is due for review in 2018.

⁶ See:

<http://www.bankofengland.co.uk/financialstability/Documents/fmi/fmisupervision.pdf>

⁷ See: <http://www.bankofengland.co.uk/about/Documents/ieo/evaluation0217.pdf>

Its report stated that: *'FMI supervision - like many other functions of the Bank of England - is funded by Cash Ratio Deposit (CRD) revenue...CRD revenue has been used to fund payments systems oversight since the Bank assumed statutory duties in this area in 2009, and it has also been used to pay for FMI supervision since 2013. In contrast, both banking and insurance supervision are funded by a levy on PRA-regulated firms.'*

The IEO report recommended that the Bank reviews its approach to funding FMI supervision and to consider whether levying fees on supervised FMIs would be appropriate. The report highlighted that a fee-based funding model potentially has two main advantages from the perspective of FMI supervision at the Bank:

'...it would potentially enhance the Bank's ability to adjust its staffing model for FMI supervision as the regulatory perimeter expands...technological change in the payments area could lead to the development of new payment providers, who, if they became systemic players, could meet the recognition criteria for supervision by the Bank.

Levying fees would [also] strengthen the Bank's ability to meet the resource requirements for large, one-off supervisory projects (provided they fell within the Bank's fee-levying powers), without having to scale back existing supervisory work....'

Following the IEO's evaluation, the Governors and the Bank's Court of Directors agreed that the Bank would consult, during 2017, on levying fees for FMI supervision with a view to any changes commencing in 2018 when the

current CRD review period comes to an end.^{8,9} This intent was set out in the Bank's published response to the IEO review and also in the Bank's Annual Report on its supervision of FMIs.¹⁰ The publication of this CP follows this commitment made by the Bank to consult on levying fees for the supervision of FMIs.

Proposed fee-levying approach

Fee-levying powers

The Bank has various powers to charge FMIs for supervisory work and applications.

- For recognised payment system operators (RPSOs), the Bank has fee-levying powers as set out in section 203 of the Banking Act 2009. Fees levied on RPSOs under the Banking Act 2009 must relate to a scale of fees approved by HM Treasury.
- For recognised clearing houses (RCHs) the Bank has fee-levying powers as set out in paragraph 36 of Schedule 17A of FSMA, which cover discharge of the Bank's functions under or as a result of Part 18 of FSMA, EMIR and Central Securities Depositories Regulation (CSDR), and Part 7 of the Companies Act 1989.
- The Bank also has certain powers to charge FMIs as set out in Regulation 6 of the Uncertificated Securities Regulations 2001 (USRs),

⁸ See:

<http://www.bankofengland.co.uk/publications/minutes/Documents/court/court1702.pdf>

⁹ See the Bank's response to the IEO's evaluation of its approach to FMI supervision at:

<http://www.bankofengland.co.uk/about/Documents/ieo/fmidr/esponse0217.pdf>

¹⁰ See:

<http://www.bankofengland.co.uk/about/Documents/ieo/fmidr/esponse0217.pdf> and <http://www.bankofengland.co.uk/publications/Documents/fmi/annualreport2017.pdf>

and Regulation 5 of the Settlement Finality Regulations (SFRs).

The Bank is proposing to charge fees to FMIs supervised under the Banking Act 2009 or FSMA (the current list of supervised FMIs is set out in table 1 below). The Bank currently supervises eleven FMIs.^{11 12}

Table 1: The FMIs supervised by the Bank

Central Counterparties (CCPs)	Central Securities Depository (CSD)	Payment Systems
CME Clearing Europe Limited (CMECE)	Euroclear UK & Ireland Limited (EUI)	Bacs
ICE Clear Europe Limited		CHAPS
LCH Limited		CLS
LME Clear Limited		Faster Payments Service (FPS)
		LINK
		Visa Europe

The Bank also proposes to charge fees for applications under FSMA, USRs, SFRs and section 170B of the Companies Act 1989.

The proposed methodology and key administrative issues for levying fees are outlined below.

¹¹ The embedded payment systems of LCH Limited and ICE Clear Europe Limited, and the CREST system operated by Euroclear UK and Ireland Limited, are also recognised payment systems under the Banking Act 2009.

¹² In May 2017 the Bank announced that the UK High Value Payment System (HVPS) will transition to a direct delivery model in which the Bank will become the HVPS Scheme operator (currently CHAPS Co) alongside its existing responsibilities for operating the RTGS infrastructure. When this transition is completed the recognition of CHAPS under the Banking Act 2009, including the Bank's powers to levy fees on CHAPS, will no longer apply.

Fee-levying methodology: Category based charging for supervision

Certain of the Bank's powers to levy fees on FMIs can be used only in relation to a specified type or types of FMI. We therefore propose to introduce 'fee blocks' for each type of FMI (i.e. separate fee blocks for: payment systems; CCPs; and CSDs). This will mean that costs will be allocated to each type of FMI and then further allocated between FMIs within that block. This approach will minimise cross-subsidisation between different types of FMIs, for example they ensure that CCPs will not cross-subsidise the Bank's work on payment systems or vice versa. The Bank's approach to FMIs which may be subject to more than one of the Bank's fee-levying powers is set out later in the CP.

The Bank's mission is to promote the good of the people of the United Kingdom by maintaining monetary and financial stability. In line with this mission, the Bank's supervision of FMIs and use of its supervisory resources is based on the risks presented by each type of FMI, the systemic importance of each individual FMI and therefore the potential impact that each FMI may present to the stability of the financial system. The Bank proposes to levy a fee on FMIs based on their systemic importance to the financial system, with reference to the allocation of supervisory resource costs across the different types of FMIs.

The Bank already has a process for categorising FMIs. All FMIs supervised by the Bank are categorised into one of three categories according to their potential capacity to cause disruption to the financial system. The assessment is made, with reference to the Bank's mission, against a range of qualitative and quantitative factors (such as the size of the FMI, activity

processed, and substitutes in the event of a disruption).

- a. Category 1 – most significant systems which have the capacity to cause very significant disruption to the financial system by failing or by the manner in which they carry out their business.
- b. Category 2 - significant systems which have the capacity to cause some disruption to the financial system by failing or by the manner in which they carry out their business.
- c. Category 3 – systems which have the capacity to cause at most minor disruption to the financial system by failing or by the manner in which they carry out their business.¹³

If the Bank decides to take forward these proposals, a future CP will outline how fees will be allocated across the categories within each fee block.

The Bank proposes to levy fees on FMIs based on their potential capacity to cause disruption to the financial system because:

- It provides a consistent and transparent measure;
- It takes into account the higher proportion of supervisory time spent on the most systemically important FMIs which could potentially have a greater impact on UK financial stability; and
- It provides a more consistent measure than levying fees based on revenue or number of

transactions across each FMI, which do not necessarily reflect systemic importance or supervisory effort.

We recognise that other fee-levying methodologies are available and that approaches differ across the fee-levying regimes of regulators such as the PRA, Financial Conduct Authority (FCA) and the Payment Systems Regulator (PSR). However, the proposal as set out above provides a transparent methodology which is appropriate to the Bank's objectives, supervisory model and fee-levying powers.

What the fees will cover

The Bank proposes levying fees for our FMI supervisory activity and policy activity which supports this, as permitted by the Bank's fee-levying powers. This includes the costs of FMI supervision staff together with relevant policy support, specialist resources and corporate services and other costs associated with the work of the FMI Directorate. Other areas of activity undertaken by the FMI Directorate not within the scope of the powers set out above would continue to be funded by CRD revenue.

Introduction of charging for certain projects

We propose levying a fee on supervised FMIs for any special project work which comes under the Bank's supervisory remit for FMIs and where it is within the scope of the Bank's fee-levying powers. These special project fees will only relate to resources which are not part of business as usual supervisory activity.

These fees would be levied on an exceptional basis to cover large-scale but time-limited 'events' or special projects. We would levy the

¹³ See:

<http://www.bankofengland.co.uk/financialstability/Documents/fmi/fminotices.PDF> The Bank originally had two categories; this has subsequently been expanded to three categories.

fees on the relevant FMIs who precipitate or are directly concerned by the activity driving the project.

Standalone fees in relation to certain applications

The Bank has powers to charge fees in relation to certain applications. The population these could apply to is broader than the current population of Bank supervised FMIs, and could include non-supervised FMIs or bodies seeking authorisation, as well as currently supervised FMIs.

Where the Bank undertakes work in the process of an initial recognition/authorisation of a CCP or CSD, we propose to charge the applicant an initial fee. There will be one application fee rate for each type of application. The fee will be based on the Bank's expected work effort in handling the application, reflecting the work we will need to undertake before the FMI is able to operate.

In respect of payment systems recognised by HM Treasury under the Banking Act 2009, there is no equivalent authorisation process and so no upfront work is required by the Bank as a pre-requisite to that payment system being recognised. Accordingly, we do not propose any charge prior to the recognition of a payment system.

Where the Bank is the relevant designating authority under the Settlement Finality Regulations, we propose to charge applicants a set application fee, based on the expected work effort incurred by the Bank in determining whether to make a designation order. We do not propose, at this time, to levy periodic fees for assessing ongoing compliance with the Settlement Finality Regulations.

We also propose to adopt the same approach in respect of:

- Overseas CCPs who apply under section 170B of the Companies Act 1989 for an order of the Bank recognising that the relevant provisions of that CCP's default rules satisfy the relevant requirements. Part 7 of that Act provides certain safeguards for CCPs' default management processes, most notably with respect to insolvency law;
- Persons seeking approval as operators of relevant systems under the USRs.¹⁴

Key implementation considerations

Below, we introduce a number of key considerations regarding the implementation of the proposed regime, in addition to the proposed fee-levying methodology discussed above.

FMIs subject to multiple regimes

A number of FMIs are covered by more than one fee-levying regime. For example, LCH Limited and ICE Clear Europe Limited are RCHs under FSMA, while their embedded payment systems are also recognised payment systems under the Banking Act 2009.

We consider it proportionate that the recognised payment systems operated by an RCH would not be treated separately as payment systems for fee-levying purposes. Rather, the Bank would levy a fee on relevant

¹⁴ This may be reviewed as part of forthcoming changes in connection with the Central Securities Depositories Regulation (CSDR).

RCHs under one fee block and in accordance with its powers under FSMA.

Timing of the levy period

Our working assumption is that the first period for directly levied fees would commence from the end of the current CRD review period (June 2018) to the end of February 2019. Following this, we would expect the fee year to be in line with the Bank's financial year, which commences 1 March.

Changes in FMI population

During a given fee year there could be changes to the population of FMIs supervised by the Bank, in the form of the recognition/authorisation of new FMIs under the relevant legislation and/or the 'de-recognition' or withdrawal of authorisation of others.

For all newly recognised or authorised FMIs, we propose a pro rata approach for our subsequent supervision activity. This would mean that the FMI pays the periodic (annual) fee for its category only for the remaining months of the fee year following its recognition or authorisation.

For FMIs that are de-recognised or for whom authorisation is withdrawn during the fee-levying year, we propose to refund for the proportion of the year remaining when a FMI is de-recognised or authorisation is withdrawn, subject to any administrative costs.

FMIs may also be re-categorised (for example moved from category 2 to category 1) in the course of a year, although we expect this will happen infrequently. The FMI will continue to pay fees based on its previous category until the new levy year when its fees will be based on its new category.

Charging points, overspends and underspends

In respect of our periodic (annual) fees, we propose to set our fees on the basis of expected business-as-usual supervisory resource expenditure for each type of FMI for the upcoming fee year. Where our spend is greater than anticipated, we will adjust our annual levy upwards for the relevant fee block for the following fee year. Where our spend is less than anticipated, we will adjust downwards our annual levy for the following fee year, effectively rebating our underspend to the FMIs within the relevant block. In this way, we will recover our actual costs of business as usual supervision.

In respect of special project fees, we will set an estimated project fee at the outset of the project. If, prior to the start of the fee collection process, the project is scheduled to start in the forthcoming year, we will collect fees (based on an estimated budget) at the same time as our periodic (annual) fee. Any over or underspend will be addressed in the next annual fee-levying process. If the project is not known and only becomes scheduled during the fee year, we will collect fees in the next annual levying process.

In respect of charges for applications received, we will charge at the point of application. We will seek to learn from any underspend or overspend and make use of this additional information to make more accurate budget forecasts when setting fees in connection with applications we handle. However, as above, we will make refunds in relation to an application or seek to 'top up' our fees to ensure we work on the basis of cost recovery.

FMI reserves and VAT

We consider that regulatory fees levied by the Bank would form part of the current operating expenses against which FMIs are expected to hold liquid net assets (equal to at least six months operating expenses) in line with the CPMI-IOSCO *Principles for financial market infrastructures*.¹⁵

FMIs that recover or recoup fees from participants or members may need to seek tax advice on whether this attracts Value Added Tax (VAT) payable by those participants/members.

We are aware that VAT was taken into account by the PSR in its own fee-levying approach. The PSR decided to adopt a fee-levying arrangement whereby the payment service providers directly participating in the designated payment systems bear the liability for the PSR's regulatory fees rather than the payment system operators. Other PSR-regulated payment systems that do not have any direct participants or members, i.e. where they also act as payment service providers, are directly liable for paying their portion of PSR regulatory fees. We have considered this approach, including by assessing what is possible under the legislation providing our fee-levying powers. Unlike the PSR, our fee-levying powers do not provide us with the flexibility to charge participants of FMIs. We will not, therefore, follow a similar approach.

Indicative costs

If the Bank decides to implement a fee levy for FMI supervision, we recognise that FMIs may need to budget for fees in 2018/19. The budget for supervision is set as part of the Bank's overall budget planning which will take place later this year. Projected figures will be

included in a subsequent consultation paper if the Bank proceeds with charging fees. To support FMIs' planning we indicate below what indicative fees would have been for the planned work in this financial year (2017/18).

By way of illustration, for the 2017/18 budget year we have estimated that £8.5 million would have been chargeable over the eleven FMIs we supervise.

This breaks down by fee block into:

Table 2: The fee blocks and estimated cost break down

Fee block	Cost (mn)
CCPs	£5.2
CSDs	£0.8
Payment systems	£2.5

Other matters

Having had regard to the public sector equality duty under the Equality Act 2010, the Bank does not consider this proposal to have any implications for equality matters. The aims behind the proposed funding arrangements include greater transparency and accountability in the delivery of the Bank's FMI supervision functions.

Feedback to this consultation

This consultation closes on 6 October 2017. Please send comments to FMIfeedback@bankofengland.co.uk by this date.

The Bank will consider the feedback received. Should it decide to take forward proposals for FMI fee-levying arrangements, more detailed proposals will be subject to further consultation.

¹⁵ The relevant Principle has been encoded in law in Article 47 of CSDR and Article 16 of EMIR.

Annex 1: FMI supervised by the Bank and the key supervisory legislation to which they are subject

<p>Central counterparties (CCPs) are regulated under FSMA as recognised clearing houses (RCHs) and authorised under EMIR. The embedded payment systems of LCH and ICE Clear Europe are also both recognised interbank payment systems under the Banking Act 2009.</p>	
CME Clearing Europe Limited	Clears a range of listed commodities contracts.
ICE Clear Europe Limited	Clears a range of exchange-traded derivatives and OTC credit default swaps.
LCH Limited	Clears a range of exchange-traded and OTC securities and derivatives.
LME Clear Limited	Clears a range of metal derivatives traded on the London Metal Exchange, and OTC metal contracts.
<p>Payment systems meeting defined criteria may be recognised by HM Treasury. Recognised payment systems are supervised by the Bank under the Banking Act 2009.</p>	
Bacs	Operated by Bacs Payment Schemes Limited (BPSL), processes higher volume and lower value payments, such as salary, benefit, Direct Credit and Direct Debit payments.
CHAPS	Operated by CHAPS Clearing Company Limited (CHAPS Co) is the United Kingdom's high-value payment system, providing real-time gross settlement of sterling transfers between participants.
CLS	Operates the world's largest multicurrency cash settlement system for foreign exchange transactions in 18 currencies, including sterling.
Faster Payments Service (FPS)	Operated by Faster Payments Scheme Limited (FPSL), processes standing orders and electronic retail transactions, including transactions generated in internet, mobile and telephone banking.
LINK	LINK is a network of card issuers and ATM deployers which allows cardholders to use their cards to withdraw cash at any ATM connected to LINK where the ATM deployer is not the same institution as the cardholder's issuing bank.
Visa Europe	A four party card scheme and cards payments processor operating in the EEA, Israel, Turkey and Switzerland, offering debit, credit, deferred debit and prepaid card products.
<p>Securities settlement systems may be regulated under FSMA as RCHs and are subject to the Uncertificated Securities Regulations 2001 in the United Kingdom. Euroclear UK and Ireland Limited operates the CREST system, which is also a recognised interbank payment system under the Banking Act 2009.</p>	
Euroclear UK & Ireland Limited (EUI) CREST	EUI operates the CREST system — the securities settlement system for UK gilts and money market instruments, as well as UK equities — which settles on a gross delivery versus payment basis (EUI also operates CREST for the purposes of settling Irish equities).