

Policy Statement

The giving of directions to qualifying parent undertakings of UK recognised clearing houses

April 2013



BANK OF ENGLAND



Background

1. This statement sets out the Bank of England's (the Bank's) policy on the use of its power to direct a qualifying parent undertaking (QPU) of a UK recognised clearing house (RCH), ie RCHs other than overseas clearing houses, under section 192C of the Financial Services and Markets Act 2000 (FSMA)⁽¹⁾ and as required by section 192H of FSMA.

Conditions for the exercise of the power of direction

2. The statutory provisions relating to the power of direction are set out in sections 192C to 192N of FSMA. In order for the Bank to be able to exercise the power of direction:

- (a) the parent company must be a QPU of a UK RCH; and
- (b) the 'general condition' must be satisfied that the Bank considers that it is desirable to give the direction for the purpose of the effective regulation of one or more RCHs in the group of the QPU.

Parent company must be a 'qualifying parent undertaking' of a recognised UK clearing house

3. A parent company of a UK RCH is a QPU under section 192B of FSMA if:

- (a) it is incorporated in the United Kingdom or has a place of business in the United Kingdom;
- (b) it is not itself an authorised person, recognised investment exchange or recognised clearing house; and
- (c) it is a financial institution of a kind prescribed by the Treasury by Order.

4. In relation to (c) above, the Treasury has laid before Parliament an Order⁽²⁾ prescribing which types of company will be considered financial institutions and, therefore, could be QPUs. The Order provides that in relation to RCHs, any financial institution is prescribed. So, for example, any entity which itself provides financial services or which operates financial market infrastructures or whose business involves the ownership or management of such entities, would be considered a financial institution.⁽³⁾

5. Any UK-incorporated parent company in a UK RCH's ownership chain may be a QPU, even if the company is not itself the ultimate parent company. If there is more than one QPU, the Bank will consider giving a direction to whichever one or more of these it considers most appropriate.

The 'general condition'

6. As outlined above, the Bank can use the power of direction only if the general condition is satisfied. The general condition is that the Bank considers it is desirable to give the direction for the purpose of the effective regulation of one or more RCHs in the group of the QPU.

7. The QPU may have a role in determining group strategy and organisation, and it may influence risk management policies, group recovery plans and the intra-group distribution of capital. The QPU may be the primary listed entity in the group and may have a significant role in capital and debt raising within the group. A QPU may also be the only entity that can alter the group structure above and around an RCH or remove some potential barriers to effective resolution. For these reasons, there are circumstances in which the Bank may wish to direct a QPU of a UK RCH to act, or to refrain from acting, in a certain manner, notwithstanding that the QPU is itself unregulated.

8. Annex A to this statement of policy contains a non-exhaustive list of possible scenarios in which the Bank may consider exercising the power of direction.

Matters the Bank must have regard to when deciding whether to use the power of direction

9. Section 192C(5) FSMA provides that, in deciding whether to give a direction, the Bank must have regard:

- (a) to the desirability where practicable of exercising its powers in relation to RCHs rather than its powers in relation to QPUs under that section, and
- (b) to the principle that a burden or restriction which is imposed on a person should be proportionate to the benefits, considered in general terms, which are expected to result from its imposition.

10. The Bank does not intend to use the power of direction to attempt to create an unlimited liability for a QPU in respect of a UK RCH, though it would expect a QPU to act as a source of financial strength and support for any regulated subsidiary.

11. Under normal circumstances the Bank would in the first instance expect to use its powers over UK RCHs to try to achieve its objectives. However, the Bank may also consider

(1) All references in this draft statement of policy to FSMA are to that Act as amended by the Financial Services Act 2012 and applied to the Bank in respect of RCHs by Schedule 17A.

(2) The Financial Services and Markets Act 2000 (Prescribed Financial Institutions) Order 2013.

(3) www.hm-treasury.gov.uk/d/condoc_fin_regulation_draft_secondary_leg.pdf.

use of the power of direction in respect of a QPU to be appropriate, for example:

- (a) where action in respect of the UK RCH fails to remedy the concerns;
- (b) where the Bank considers that action against the UK RCH is likely to fail to remedy the concerns;
- (c) where the UK RCH fails to comply;
- (d) where the Bank considers the UK RCH is likely to fail to comply;
- (e) where the UK RCH does not itself have the ability to effect the desired change;
- (f) where the issue can only be resolved effectively by the QPU; and
- (g) in cases of urgency.

12. In some stressed circumstances, potential conflicts of interest between a QPU and a UK RCH may become heightened. The RCH may be less able to resolve issues without the support of the QPU, and the ability to direct the QPU may therefore become more important.

Content of the direction

13. Section 192D(1) FSMA provides that a direction made under this power may require the QPU either to take specified action or to refrain from taking specified action. Section 192D(2) goes on to provide that a requirement may be

imposed by reference to the QPU's relationship with its group, or with other members of its group. The requirement could be imposed either in relation to a specific intra-group relationship that is causing concern, including a relationship between sister companies, or by reference to the group generally if the concern is in respect of group-wide issues.

14. Where desired actions are reserved to the shareholders of the QPU the relevant direction cannot address the shareholders directly. In such cases the direction would instruct the entity to facilitate the decision of the shareholders, for example by calling a general meeting and proposing the motion required to achieve the desired action.

15. Section 192D(3) provides that a requirement may refer to the past conduct of a QPU (for example, by requiring the QPU to review or take remedial action in respect of past conduct).

16. A requirement imposed by the direction may be expressed to expire at the end of a specified period, but this does not affect the power to give a further direction imposing a new requirement. Equally, a requirement imposed by the direction may have no specified end date. The direction may be revoked by the Bank by written notice to the QPU to which it is given, and ceases to be in force if the undertaking to which it is given ceases to be a QPU.

17. Annex B contains a non-exhaustive list of the types of direction which the Bank may consider making.

Annex A

Non-exhaustive list of possible scenarios in which the Bank may consider exercising the power of direction

Examples of scenarios in which the Bank may consider the exercise of its power of direction include, but are not limited to:

- insufficient quality or quantity of own funds or liquid assets or other assets are made available to the RCH to meet its requirements;
- intra-group transactions, or allocation of risks and financial resources, that do not meet the standards expected by the Bank;
- group-wide recovery and resolution plans that do not meet the standards expected by the Bank (as applicable to the RCH);
- where there are barriers to the resolution of the RCH that it is most appropriate to mitigate or remove at the level of the QPU;
- where action at the level of the QPU is required to improve resolvability of the RCH;
- group-wide remuneration policies that do not meet the standards expected by the Bank;
- a proposed acquisition by the QPU that may affect the compliance of the RCH with regulatory requirements;
- where actions of the QPU in a recovery or resolution scenario may increase the chance of disorderly failure;
- where only the actions of the QPU in relation to one of its unregulated subsidiaries may maintain the stability of the RCH, particularly in stressed circumstances (for example where a regulated firm is reliant on services provided by an unauthorised sister company);
- where risks generated in an unauthorised part of the group could affect the stability of the RCH, or the group as a whole;
- insufficient quality or quantity of own funds or liquid assets or other assets being available to meet group needs or requirements within the group;
- insufficient transferability of a group's own funds or liquid assets to support group needs or requirements within the group;
- complex or opaque group structures that hinder the RCH's and/or the Bank's ability to assess and manage the risks generated by the RCH's membership of its group;
- group-wide risk management or governance arrangements that do not meet the Bank's and/or internationally agreed standards;
- systems and controls to manage group risks that do not meet the standards expected by the Bank;
- acts or omissions of the QPU that are affecting, or may affect the RCH's ability to continue to meet recognition requirements or other obligations to which it is subject under FSMA or directly applicable EU regulations;
- where the QPU directors exert dominant influence on the RCH's board to obstruct its independence;
- where one or more directors of the QPU appear not to be fit and proper, or suitable.

Annex B

Non-exhaustive list of possible directions the Bank may consider making

Directions which may be made by the Bank may include, but are not limited to:

- a requirement to improve the system of governance or controls at group level and/or in relation to subsidiary undertakings where this is necessary for effective supervision of the RCH;
- a restriction on dividend payments, or other payments in respect of capital instruments, in order to retain capital in the group;
- a requirement to move funds or assets around the group to address risks more appropriately;
- a requirement for the group to be restructured to remove any material impediments to effective supervision of the RCH;
- a requirement to stop or impose restrictions on an acquisition or divesture (taking account of any potential conflict with takeover rules and the EMIR provisions relating to certain acquisitions);
- a requirement to ensure the continuity and quality of service provided between relevant group entities and that outsourcing arrangements between group undertakings can operate effectively;
- a requirement to raise new capital;
- a requirement to take steps to facilitate the removal from office of directors of the holding company who do not meet the Bank's expectations as regards being fit and proper to direct a QPU;
- a requirement to remove barriers to resolution of an RCH.