CLEARING POLICY PRIORITIES

KLAUS LÖBER
Chair, CCP Supervisory Committee - European Securities and Markets Authority (ESMA)

2022 Priorities of the ESMA CCP Supervisory Committee

2022 will bring a change of emphasis in the ESMA CCP Supervisory Committee (CCP SC). While it will continue delivering on its recurring tasks and the workstreams launched in 2021, the CCP SC will aim at developing a more forward-looking and risk-based supervisory perspective to further enhance supervisory convergence and address on-going and emerging risks.

2022 holds a number of key deliverables, which the CCP SC will address with high priority. First, the CCP SC will be looking to finalise the tiering assessments and the reviews of recognition of third-country CCPs (TC-CCPs) already recognised by ESMA and to complete the review of the underlying Memoranda of Understanding with the relevant third country authorities by end of March 2022. It will also assess pending and new requests for recognition by June 2022, depending on the adoption of new equivalence decisions by the European Commission which remain a precondition for CCP access to the EU market.

June 2022 also marks the end of the original temporary equivalence and recognition decisions for the UK CCPs. While the CCP SC and the ESMA Board of Supervisors have concluded at this stage that the costs of non-recognition outweigh the benefits, they have also identified a number of risks and vulnerabilities for which mitigating measures should be considered. In this respect, it has been suggested to develop incentives for EU members to reduce their exposures to UK CCPs, but also enhancing ESMA's powers in crisis-management situations, as well as in recovery and resolution. The CCP SC will continue to work closely with the European Commission and the relevant national authorities on follow-ups to the assessment and the Commission's decision on extending the temporary equivalence.

In the meantime, the CCP SC is pursuing a deeper and more risk-based supervision of Tier 2 CCPs aimed at identifying and addressing any actual or potential risks, using the supervisory tools introduced under EMIR 2.2. It will also follow a data-driven approach to closely monitor relevant developments for other TC-CCPs, in particular where heightened risks for the Union may exist.

Looking to the EU-CCPs, the CCP SC will continue to work towards enhancing supervisory convergence, conducting mandatory reviews of NCA decisions and validating significant changes to CCP risk models and parameters. Moreover, it will also increasingly focus on cases of supervisory divergence across the Union, assessing where follow-up measures may be necessary to ensure greater supervisory convergence.

As already initiated last year, the CCP SC is continuing to develop its annual heat map of major risks faced by the EU with respect to CCPs – with operational risks, including cyber risk, expected to remain high priority. ESMA will soon be finalising the analysis of the results of the 4th stress-testing exercise and the 2021 Peer Review, which should help the CCP SC in developing a common view to address certain operational risks.

The CCP SC is also starting novel work with an upcoming consultation to better understand how climate risks impact CCPs, what can be done to address identified risks, and which specific components ESMA could integrate in its stress-testing exercise to have a more complete view on the resilience of EU and Tier 2 CCPs.

Other areas of risks which will receive increased attention are those linked to financial innovation. While technology-based innovations may bring advantages in terms of efficiency gains, careful consideration will be brought both to whether certain new products based on digital assets (e.g. crypto-currencies or stablecoins) are suitable for clearing and how new technologies may further affect the clearing market structure and potentially its integration with other key functions, such as trading and settlement.

Finally, while interconnectedness is often raised as an important source of risk faced by CCPs, certain aspects may merit more attention. One such aspect results from the same broker-dealers acting as clearing members to multiple CCPs around the globe and concentrating considerable risks among the top 20 clearing service providers. This raises questions in case of multiple member defaults, regarding contagion effects to non-defaulting clearing members, their clients (e.g. access to clearing and porting) and the non-centrally cleared space more generally. Similar considerations may apply concerning certain third-party providers given the increasing reliance of CCPs on the outsourcing of certain services across the globe (e.g. cloud-based activities).

To address these horizontal and multi-faceted issues, ESMA will continue strengthening its cooperation with EU and national banking and market supervisors, and also connect with other relevant authorities in the field of climate risk and cybersecurity. The increasing degree of interconnectedness and cross-border nature of CCPs also entails that ESMA is further strengthening its engagement with relevant global standard setting bodies in 2022.

JOHN BERRIGAN

Director General,
DG for Financial Stability,
Financial Services and
Capital Markets Union -
European Commission

Building an attractive EU clearing framework

Before the departure of the United Kingdom from the European Union, the City of London became the main financial hub for the trading and clearing of derivatives in the European Union. The build-up of such a concentrated position was made possible because the United Kingdom was part of the Single Market and therefore subject to a set of commonly agreed stringent rules. BREXIT was a fragmenting event, with consequences in terms of financial stability. Even though the UK has so far faithfully transcribed EMIR– the European framework for CCPs – into common law, UK CCPs now operate outside of the Single Market and the EU's regulatory framework.

In mid-October 2019, the European co-legislators adopted a set of targeted amendments to EMIR to strengthen the supervision of CCPs in light of their growing systemic importance. The objective of the compromise reached by the co-legislators was mainly to improve the supervision of third-country CCPs that provide services to EU firms according to the risk they present for the stability of the EU financial system.

The new rules enhance the supervisory role of ESMA and EU Central Banks over third-country CCPs. The amendments introduced a new category of third-country CCPs that are systemic for the financial stability of the EU ('Tier 2 CCPs'), and that will become subject to specific requirements and direct supervision from ESMA. These CCPs could also be recommended to be relocated if ESMA determines that they are so systemic that joint supervision would not be enough to mitigate the risks they pose. ESMA has assessed the super systemic nature of the Tier 2 CCPs and has found that some of their services were indeed critical to the financial stability of the Union. It has concluded however that at this point in time, the costs associated with a forced relocation were too high compared to the benefits it would bring. Accordingly, it seems appropriate to take necessary steps to build the EU's own capacity for clearing and reduce an excessive reliance on UK CCPs.

In September 2020, the Commission adopted a time-limited equivalence decision for UK CCPs until 30 June 2022 to avoid the financial stability risk an abrupt disruption in the access of EU participants to UK CCPs would have brought. In this equivalence decision market participants were urged to take action and reduce their exposures to UK CCPs. The move so far has been marginal and mostly concerned low risk products rather than the more complex and risky positions still cleared in the UK.

A reduction of exposure to UK CCPs is needed; EU clearing market must evolve to help achieve it.

Over the course of 2021, the Commission established a Working Group (together with the European Central Bank, the European Supervisory Authorities and the European Systemic Risk Board) to explore the opportunities and challenges involved in transferring derivatives from the UK to the EU. The Commission learnt from this group that a combination of different measures to improve the attractiveness of clearing, to encourage infrastructure development, and to reform supervisory arrangements are needed to build a strong and attractive central clearing capacity in the EU in the years to come. The Commission also found that the timeframe of June 2022 was too short to achieve this and that an extension of the equivalence decision for UK CCPs is necessary.

But this extension of equivalence does not address the medium-term financial stability concerns and the Commission intends to come forward in the second half of 2022 with measures to make EU CCPs more attractive to market participants, taking into account the results of the assessment undertaken by ESMA in 2021 on the super systemic nature of the two Tier 2 UK CCPs.

Firstly, by building domestic capacity: measures to make the EU more attractive as a competitive and cost-efficient clearing hub, and so incentivise an expansion of central clearing activities in the EU, will be needed. In this context, following a targeted public consultation we will explore ways to enhance liquidity in EU CCPs and to expand the range of clearing solutions on offer from EU infrastructures.

Secondly, if the EU is to increase its capacity for central clearing, it is essential that the related risks are appropriately managed and the EU's supervisory framework for CCPs is strengthened, including a stronger role for EU-level supervision.

This proposed way forward strikes a balance between safeguarding financial stability in the short term – which requires taking an equivalence decision to avoid a cliff-edge for EU market participants – and safeguarding financial stability in the medium term – which requires us to reduce this risky over-reliance on a third country. Importantly, this legislative initiative scheduled for the second half of 2022, will focus on enhancing the liquidity and the attractiveness of EU CCPs and will not be anticipating the general review of EMIR scheduled for 2024.

CHRISTINA SEGAL-KNOWLES

Executive Director for Financial Markets Infrastructure - Bank of England

The Bank of England's approach to cross-border clearing

Christina Segal-Knowles discusses the Bank of England's consultations on new policies that will shape how it regulates and supervises overseas central counterparties (CCPs).

After the 2008 global financial crisis, the G20 set out to do something quite remarkable. Rather than turning inward to protectionism and fragmentation, the world's major economies committed to work together to address the lax regulation that had enabled the crisis, to repair our financial systems, and crucially, to maintain global capital flows. They set out to make the system safe, but keep it open at the same time.

The G20 put in place reforms designed to make the global financial system simpler - to untangle the spaghetti bowl of bilateral derivatives trades which caused Lehman's failure to spark a global crisis. They incentivised, and for many products mandated, the central clearing of derivative trades. This brought greater stability to derivative markets by ensuring that if a major financial institution were to collapse, you needn't worry about a domino effect where the failing firm's derivatives contracts could threaten the viability of any number of other firms.

These reforms have worked. The market turmoil in 2020 sparked by the global pandemic could very easily have tipped into a panic and a financial crisis. But thanks in part to derivatives reforms, there was no panic about counterparty credit risk and no tangled web of vulnerability.

The task for regulators today is to ensure that CCPs which are increasingly at the heart of the financial system are robust and resilient, without jeopardising the very reforms that have made the system safer.

In the UK we are consulting on a new framework for recognition and supervision of non-UK CCPs wishing to serve UK clearing members, which we believe will allow us to achieve both safety and openness.

This includes 'tiering', which is the classification of individual CCPs according to the level of systemic risk they could pose to UK financial stability. The framework aims to ensure that the CCPs on which the UK financial system relies are supervised and regulated to high standards regardless of where they are located.

At the same time the framework acknowledges that the reforms which made global derivatives markets safer rely on large, cross border CCPs with deep pools of liquidity. This is a deliberate feature, not a bug. If every jurisdiction which used major global CCPs were to regulate them, they may have to adhere to several dozen sets of rules, regulations and supervision. This would create complexity, with multiple regulators regulating the same entity, or fragmentation, if regulators require the entity to split itself into smaller parts. Both risk unravelling the very reforms that have made our system safer.

Ensuring that cross-border CCPs are safe, and preserving post crisis reforms, need not be incompatible. Two key features of our new approach aim to support openness without sacrificing safety:

First, our proposed approach puts cooperation at its heart. We recognise that the benefits of direct supervision by UK regulators are unlikely to outweigh the potential detriment to post-crisis reforms or global financial stability from having multiple supervisors and regulators of CCPs. For CCPs where we have a deep ongoing relationship with their supervisor, we would seek to place informed reliance on the home authorities rather than directly supervising the CCP ourselves.

Second, our approach is proportionate. We seek to ensure that the authorities with the greatest interest in a CCP in the event of its failure have the greatest input in its regulation and supervision. This reflects the fact that jurisdictions with firms representing the highest default fund contributions to a CCP will bear the burden in the event of CCP failure.

Where the UK has a smaller interest in a CCP relative to other jurisdictions, the Bank will be more inclined to rely on the home authority. But where the UK has a greater interest in a CCP relative to other authorities, we should expect more assurance that the home authority is delivering robust and equivalent supervisory outcomes, firmly rooted in international standards, and that we have a relationship on which we can rely.

The broader G20 project of repairing our financial systems and maintaining the global flow of capital is ongoing. The system continues to evolve. Safe openness will require tending.

But in the narrower space of CCP cross-border supervision we have laid out a possible path forward, and we are eager to work with jurisdictions to ensure a path that preserves both safety and openness. We envision that our cooperation-centric, proportionate approach will enable us to fulfil our mandate to protect UK financial stability without sacrificing the post-crisis reforms to derivative markets that have made us all safer. The consultation closes on Friday 25 February 2022.

JULIAN REISCHLE

Director General Payments and Settlement Systems - Deutsche Bundesbank

Euro clearing to come home – one year after Brexit

One year after Brexit, the clearing landscape has not undergone any dramatic transformation. The amount by which exposures were reduced on a voluntary basis changed only minimally in 2021, i.e. only relatively small clearing volumes were shifted to the European Union. Nevertheless, over a period of four years, OTC Interest Rate Derivatives volumes cleared by EU-based Eurex Clearing have reached a market share of roughly 21%. Even after Brexit, systemically important UK CCPs (Tier 2) could continue to offer clearing services due to an equivalence decision adopted by the European Commission and a corresponding declaration made by ESMA. However, this equivalence decision is due to expire at the end of June 2022 and it was not clear for a long time where the European Union would go from there.

As a result, 2021 was marked by uncertainty for UK Tier 2 CCPs and EU clearing members. Shortly before the turn of the year, ESMA's decision not to recommend a derecognition of UK Tier 2 CCPs and their clearing services to the Commission helped to shed some light on the way forward. In addition, ESMA recognised three clearing services (one from LCH Ltd. and two from ICE Clear Europe Ltd.) as being of substantial systemic importance for EU financial stability. In sum, ESMA's decisions reflect that, at this stage, the costs and risks to the European Union of derecognising these clearing services would outweigh the benefits. However, the risks and vulnerabilities identified by ESMA with respect to systemically important UK Tier 2 CCPs should be mitigated through various measures explicitly advocated by ESMA. These measures include the consideration of appropriate incentives to reduce the size of EU exposures to UK Tier 2 CCPs in the medium term.

ESMA's decision not to directly push for relocation appears reasonable. After all, the issue is anything but trivial. There are still concerns in the market that relocation would lead to liquidity fragmentation and additional costs e.g. due to higher margin requirements. Moreover, competitive disadvantages for EU participants in a highly global market must be avoided. Therefore, it seems more favourable to incentivise clearing in the European Union rather taking the route of enforcing relocation. It seems obvious that the current situation of EU market actors having large exposures to UK CCPs cannot be considered sustainable. With that in mind, appropriate reflection on long-term implications for financial stability and the integrity of the European market is needed.

The future of EU financial services lies within the European Union.

While the Commission recently announced that it would consider a further extension of the transition period early this year, the time gained should be used to seek appropriate ways to reduce the reliance on UK CCPs. There are two avenues to explore: further enhancing the capacity of EU CCPs and strengthening the powers to supervise CCPs within the European Union.

At the same time, it goes without saying that the success of ESMA's recommendations should not be taken for granted. Only if there are effective incentives for market participants to reduce their exposures they are likely to consider shifting business to EU CCPs, which in turn might result in a strengthening of the EU financial market. I believe that this can be best achieved by further improving clearing services in the European Union, by bringing additional market volume to central clearing and by ensuring that all relevant EU market participants build up clearing capacity in the European Union. This requires that the industry looks at this topic from a long-term perspective, develops appropriate and robust strategies and puts forward concrete proposals for efficient solutions. This might also include making legislators aware of potential problems and proposing supportive action that legislators can take.

As UK CCPs will remain systemically important to the European Union for the time being, focus should also be placed on close and constructive cooperation with the UK authorities in the coming years. EMIR 2.2 grants enhanced powers to EU regulatory authorities to supervise and oversee UK Tier 2 CCPs and to protect the financial stability of the EU financial system. There is some confidence that there will also be appropriate regulation of CCPs in the United Kingdom, which has been boosted by the recent decision by the country's HM Treasury to implement EMIR 2.2. In addition, there is no need to establish dedicated supervision of EU CCPs at the EU level at this stage; what needs to be done instead is to continue to maintain and strengthen national powers and the cooperation arrangement that already exists for the supervision of EU CCPs.

The future of EU financial services lies within the European Union. If the market is looking for certainty, it should shift its focus towards the European Union and strengthen its clearing capacities, especially for euro clearing, within the jurisdictional boundaries of the European Union.

CLAUDINE HURMAN

Director Infrastructures, Innovation and Payments - Banque de France

Sailing in clear waters: building the EU clearing pool

One year after Brexit, the clearing landscape may look like the Channel in some mornings: apparently still from afar, yet subject to high currents underneath the surface. While in Europe the market shares of CCPs have not drastically changed over the past year, the clearing offer is progressing slowly on the continent, yet at an increasing pace. Several EU market venues, infrastructures and participants are proposing new strategies and products relying on continental solutions, to reapen the opportunities that a strong EU post-market sector can bring for the Capital Markets Union.

This paradigm shift does not come from nowhere. 2021 has seen a rising awareness on the unsustainability of a status quo under which EU financial entities would remain excessively dependent on offshore infrastructures. Following the assessment procedure under Article 25(2c) EMIR, ESMA, ESRB and the Eurosystem evidenced that the activities of some UK CCPs on interest rate and credit derivatives in EU currencies are substantially systemic for the Union. While they did not advocate for immediate de-recognition of these CCPs, they highlighted the financial stability risks to the EU on the medium term, which could especially materialise in a crisis. To reduce such risks, rebalancing clearing exposures towards the continent is indispensable. This implies two main lines of action.

The first one is strengthening the clearing offer in the EU. It is mainly the EU industry's role to adapt to the demand in order to attract EU and non-EU members and clients. In the context of commercial efforts underway, it is time for EU CCPs to challenge current monopolies on particular products such as interest-rate products. EU members need also to anticipate their clients' appetite for EU-based clearing and build on their steering role to enhance the liquidity of the EU clearing pool. By starting to locate in such CCPs their activities which are not subject to global competition, such as ALM, they can deliver progressively on their stated intention to maintain active accounts in EU CCPs.

Micro and macro prudential tools could reward a gradual reduction of exposures to UK CCPs.

The second line of action is taking supervisory measures to incentivise clearing members to clear in EU CCPs. It is now necessary that the market internalises the financial stability requirements linked to overreliance on offshore entities that represent "single points of failure". In this context, the upcoming renewal of the temporary equivalence provides a unique opportunity to set the tone for effective exposure reduction and pave the way for the implementation of prudential incentives, so that continued access to UK CCPs is not seen as a "blank check". More precisely, micro and macro prudential tools could reward a gradual reduction of exposures to UK CCPs. Since such measures would not require any legislative change, they could be triggered in the coming months, and spread over appropriate time to ensure a smooth rebalancing.

On the supervisory aspect, the revision of EMIR, expected in the medium term, may help support these evolutions.

Indeed, as mentioned by the Commission, the supervisory framework of EU CCPs will have to be enhanced as some of them will become more systemic following the rebalancing of exposures. Two concepts are important in this regard: collegiality and proportionality. One notable feature of EU supervision is that it relies on colleges of authorities with concrete authorisation powers. The European Union is very much advanced in terms of cross-border cooperation on CCPs and any review of EMIR should capitalise on this asset. The powers of EMIR colleges could be reinforced with more binding opinions on key CCP projects. ESMA's influence could be more pronounced and its governance opened to all the authorities concerned by CCP issues. The supervisory framework should also be tailored to EU CCPs' systemic footprint, as in the tiering system applied to non-EU CCPs.

While taking these steps towards growing the EU clearing pool, EU authorities should have a say, not only a look, on how the risks of substantially systemic third-country CCPs are managed – to the extent that they expose the European financial sector-. In its recent report, ESMA made some proposals, inter alia to fix the flawed comparable compliance framework and to require EU approval of recovery and resolution plans. These changes are needed to address critical gaps. Nonetheless, they should not be seen as a substitute for rebalancing the systemic clearing activity towards the Union. This is the only way to ensure the long-term resilience that floats everyone's boat.

Article co-written with Alexandre Garcia, Financial Market Infrastructure Expert, Banque de France

ISABELLE GIROLAMI
Chief Executive Officer - LCH Limited

Supporting CCP resilience and financial stability

To support financial stability, CCPs manage a wide range of risks. Whilst recent events have proven their resilience facing counterparty and market risk, more is needed to support their operational resilience objectives.

When it comes to financial resilience, LCH was at the forefront of the volatility resulting from the Covid-19 pandemic. Our risk models performed as designed, with no adjustment required to accommodate the heightened volatility and with our Initial Margin (IM) requirements increasing only by about 15% compared to Business As Usual (BAU), most of which was due to increased volumes rather than risk models. Our risk framework, and most importantly, our approach to margin requirements during normal times and our Anti-Procyclicality Control (APC) tools, managed to alleviate pressure by enhancing the resilience of financial markets.

This is complemented by the transparency CCPs provide to the market, clearing members and their clients through the CPMI-ISOCO public quantitative disclosures, margin models, credit and stress testing, volume, and transaction metrics. This transparency is, however, not matched in the uncleared space, and further work could be done to support better markets understanding for the uncleared space.

An important aspect of a CCPs' resilience is its membership and the markets they serve. Global financial markets best operate when they can freely balance supply and demand supported by highly capable and resilient infrastructures and participants. From a financial stability perspective, the potential reduction in size and diversity of participants poses substantial risks, particularly with regards to default management. Diversified clearing services, supported by greater liquidity and a wide high-quality membership that is subject to different economic dynamics, has strong benefits to financial stability. In that sense, we welcome ESMA's recent statements on the importance for European financial markets of clearing services provided to EU market participants by non-EU CCPs. We also support ESMA's intention to reinforce its supervisory and crisis management toolbox and enhance cooperation with third country authorities.

Clearing remains the safest way to manage ongoing financial risk, which is why equal focus must be place on new client clearing models developed at CCPs to enable clients' (i.e., funds) direct access to clearing facilities. At LCH we have developed Sponsored Clearing models enabling clients to access LCH's RepoClear as a clearing member through a sponsored bank acting as a sponsoring agent. Such membership models have the potential to overcome liquidity management and operational capability barriers certain clients might be faced with.

Digital transition should be fully endorsed as it supports CCP operational resilience.

The operational resilience of CCPs and market participants at large is also core to financial stability and is an increased focus of both regulators and the industry. The industry has made considerable investments over the years across to ensure enhanced operational resilience including to cyber risk. We continue to have operational resilience at the centre of our enterprise risk management framework, supported by effective tools and processes. We believe the right steps are also being taken at the legislative level, including through the EU Digital Operational Resilience Act (DORA), which we fully support to reinforce EU financial system.

Particular attention will be needed to ensure a calibrated regulation of ICT service providers, specifically cloud providers, which are fast becoming crucial actors in the operational resilience scene. To keep pace with technology developments and increase our operational resilience, CCPs need to access best-in-class technology supported by best-in-class staff, including newly developed applications that might only be available on the Cloud. This often means migrating activities with Cloud Services Providers to leverage their expertise and cyber tools. This digital transition should be fully endorsed as it supports CCP operational resilience, even if this means working collectively to increase tool and controls to support this transition. We need to support innovation to increase operational resilience

All in all, I believe the unexpected Covid-19 crisis has validated the global efforts that took place after the 2008 financial crisis and more recently from a non-financial risk perspective. It has also demonstrated the value of constant, coherent, and timely regulatory coordination, given the global nature of today's financial markets. We encourage regulators to cooperate as much as possible, both at the EU and at the international level, to ensure not only a level-playing field among all market participants but a common and harmonised approach of high standards to support financial stability and address the wide-range of risks it faces, including cyber risks.

The resilience of our system is a key condition to support the real economy and finance the twin green and digital objectives shared across jurisdictions.

ERIK TIM MÜLLER

Chief Executive Officer - Eurex Clearing AG

Quo vadis EU CCPs? Fostering global competitiveness and strategic autonomy

CCPs' resilience during both the Covid-19 pandemic and in the aftermath of Brexit proved that the G20 reforms have borne fruit, reminding us that efficient and robust risk management as well as a healthy clearing ecosystem are key for preserving financial stability and ensuring a sustainable recovery.

Without doubt, the EU has not only set the global benchmark with EMIR, safeguarding the role of CCPs as independent and neutral risk managers of financial markets, but clearly continues its path of stability and resilience with the implementation of the CCP recovery and resolution framework.

While we take pride at Eurex Clearing in having received the award for the globally leading risk management system, we believe it is of critical importance to continue the EU's regulatory thought-leadership, setting the right incentives for a globally competitive and innovative clearing landscape.

The recent decision to grant an extension to the temporary equivalence for UK CCPs until summer 2025 is symbolic in this regard, having been accompanied with the announcement for a consultation and subsequent action on measures to support the EU's objectives.

In light of the ESMA CCP Supervisory Committee assessment around Tier2 CCPs, concluding that UK CCPs' business denominated in Euro are of substantial systemic importance to the EU, it does not come as a surprise that the EU has repeatedly stressed the need to reduce reliance on UK CCPs and keep building up clearing capacities in the EU.

A number of elements could prove valuable in this regard, ranging from the ESMA and ESRB recommendation on prudential incentives, over an improved time-to-market for launching new products and services through to an end of the pension scheme arrangements (PSA) exemption, structurally boosting a healthy clearing ecosystem. As part of this broader process, it will be critical to remain conscious of global competitiveness, especially in spheres where EU standards have no equivalent. While EU CCPs have demonstrated a higher level of resilience due to their conservative margin models and anti-procyclicality tools (APC), a level playing field should not only be ensured vis-à-vis 3rd country CCPs but also with the bilateral space. This is particularly important as cases such as Archegos area an unfortunate reminder that we should not waver in our commitment to improve risk management standards and transparency.

The EU must continue on its path of "open strategic autonomy and resilience" with strong EU CCPs at its heart.

Recent work around non-bank financial intermediation and "shadow banking" has emphasized this need to reassess certain market realities further, noting a significant growth of this segment since the global financial crisis and the necessity to review risk management standards more generally.

Moreover, as the EU advances on uncleared margin rules (UMR), Basel III and a review of clearing obligation mandates, ensuring access to central clearing is key. In order to contribute to a healthy clearing ecosystem in the Union, we are committed to further improving client access models, reducing concentration of client clearing, and maximizing netting efficiency as well as CCP risk management capacities. In this line of thought, we encourage regulators to help us empower clients by removing unnecessary regulatory barriers and avoid disincentivizing CCP risk management.

With the global political landscape increasingly pointing to geopolitical tensions and frictions, the EU must continue on its path of "open strategic autonomy and resilience" with strong EU CCPs at its heart. Let us not forget that the Covid-19 realities are still the decisive factor driving our broader macro-economic outlook – but concrete jurisdictional realities may prove increasingly different, noting that the policy-course driven by the US FED or the UK BoE is not mirrored by the ECB.

Safeguarding the Euro as the most decisive symbol of EU economic and financial integration will remain key for the Union's future but is also an important global responsibility around one of the world's most important currencies. With Brussels forging hot iron and tackling the important next steps on future economic and financial integration, the role of EU capital markets will continue to become more critical, requiring a more strategic approach to match expectations.

Against this background, I invite policymakers and the industry to continue moving the needle together, fostering an innovative and globally competitive EU clearing landscape – and embarking on our joint endeavour to guarantee financial stability as the backbone of sustainable economic growth in the interest of future generations.

HAROUN BOUCHETA

Head of Public Affairs -
BNP Paribas Securities Services

Third-country and EU CCPs: many challenges still ahead one year after Brexit

One year after Brexit, central counterparties (CCPs) continue to raise questions on important matters such as financial stability, monetary policy and competitive landscape. After a significant policy work and an ongoing dialogue between authorities and the industry, joint efforts should be pursued to address the remaining uncertainties.

UK CCPs - new "Strategy on Clearing"

The recent decision from the European Commission (EC) to propose to extend by three years the equivalence decision for UK CCPs should be warmly welcomed.

The extension for this period will leave sufficient time to create a robust, competitive and liquid European clearing capacity and further reduce the exposure on UK CCPs for some EUR denominated instruments. It will also allow to meet the other strategic autonomy objective of the EU to preserve competitive EU financial actors in the European and global markets.

The extension is also highly relevant as it covers all CCPs established in the UK, and not only the most systemic ones (Tier 2 CCPs). While the EUR Interest Rate Derivatives (IRD) segment cleared by Tier 2 CCPs is often seen as the only one, the inability to access to Tier 1 UK CCPs and other non-systemic segments of Tier-2 CCPs raises serious concerns.

The EC is about to launch a new "Strategy on Clearing" to reduce in the medium term the "overreliance on UK CCPs". An holistic approach looking at all aspects of the market should be encouraged as it includes both:

a) Demand side : increase the size and liquidity of EUR clearing market in the EU by:
- easing the ability of a broader base of EU market participants to centrally clear,
- incentivizing the voluntary clearing of EU public institutions,
- encouraging all EU institutions subject to EMIR clearing obligation to open and maintain an active account at an EU CCP for the clearing of EUR IRD products.

b) Supply side : improve individual EU CCP offerings, enhance technological capabilities, address gaps in products.

If by the end of the equivalence extension period all these actions have not sufficiently reduced the financial stability risks related to non-EU central clearing arrangements, the implementation of legislative measures could then be decided.

To avoid situations where EU members would be hampered to serve their clients solutions are needed.

However, such measures would need to preserve the ability of market making and client clearing activities of EU institutions to engage with all clients including non-European Economic Area (EEA) clients outside the EU as well as EEA clients not subject to the clearing obligation. Prudential penalizing measures affecting these international activities should be avoided as well.

The contingent legislative measures should be framed in advance and their implementation should be done gradually to ensure EU policy would successfully work.

Other third-country CCPs

A growing concern for EU clearing members and for their clients is about conditions of access and prudential treatment in the following situations:

- third-country CCPs ("TC CCPs") already benefiting from equivalence but not yet recognized by ESMA (US CCPs supervised by the SEC),
- TC CCPs where neither equivalence nor recognition have been granted yet (ex : China, Russia, Turkey),
- TC CCPs which could lose their recognition in the context of the ongoing reassessment process performed by ESMA in accordance with EMIR 2.2 (ex : India).

If no equivalence and/or recognition is granted by 28 June 2022 or alternatively if the Qualified CCP (QCCP) status is not extended further, these TC CCPs will lose their QCCP status in the EU resulting in a massive increase of capital requirements for EU firms. In such a case, EU firms would not remain competitive and would need to exit from these activities, and EU clients will be obliged to clear through non-EU firms for their investment and hedging needs. EU clearing members will be impacted for OTC derivatives but also for cash equity, listed derivatives and fixed income securities.

To avoid situations where EU clearing members would be hampered to serve their clients, including the European ones, on a fairly competitive basis with their non-EU peers, tailor made solutions are needed.

Need to avoid procyclical effects of margins and ensure financial stability in case of recovery or resolution

The recent regulatory developments on margin practices have highlighted that the responsiveness of centrally cleared IM models to market stresses may lead to procyclical effects. Although CCPs should retain the ability to proactively improve their models, there is a need to better disclose CCPs modelling choices to meet legitimate expectations and predictability needs of clearing members and their clients.

Finally, Europe is about to finalise the framework around the recovery and resolution of CCPs which is a key component of the financial stability. Some important issues, like skin in the game and resolution plans, still need to be addressed to avoid crisis in default situations potentially faced by CCPs.