STRENGTHENING EU CLEARING

KLAUS LÖBER

Chair, Central Counterparties Supervisory Committee - European Securities and Markets Authority (ESMA)

Getting EMIR right

EMIR 3 is both an essential and a necessary review of the CCP regulatory and supervisory framework. Four years after the end of the negotiations on EMIR 2, significant events have impacted the European Union: the withdrawal of the UK, a global pandemic and war at our borders. All these developments have also had a direct impact on CCPs and the clearing ecosystem and have uncovered a number of weaknesses which need to be addressed.

First and foremost, the Commission has made important proposals to adapt to the new reality where the UK has now left the Single Market. In our assessment published in December 2021, ESMA identified a number of substantial risks and vulnerabilities attached to the continued recognition of three clearing services in the UK. While the report concluded that the costs of withdrawing recognition would outweigh the benefits, it also outlined a number of possible measures to incentivise EU clearing participants to reduce their exposures towards Tier 2 CCPs and to rebalance these towards EU CCPs.

Among the options considered, the active account requirement, now embedded in the Commission's legislative proposal, plays a central role. It would provide a balanced approach to ensure that an increased proportion of critical clearing services takes place in the Union, while maintaining EU markets open to the world. ESMA stands ready, with our expertise and EU-wide view on markets, to support its implementation.

Should potentially systemic risks be transferred to the Union as intended, it would be logical and critical to further strengthen supervisory convergence within the EU, as disruptions at CCPs based in one Member State could have substantial negative effects across the continent. The Commission's proposals in this regard are vital, as they would expand the scope of the CCP Supervisory Committee's competences and enhance the tools promoting supervisory convergence. The proposal to grant voting rights to ESMA and to chair the EMIR colleges would also go a long way in ensuring consistency, as ESMA is the only Authority participating in all colleges and thus able to provide a genuine EU-level perspective.

> **EMIR 3 is both an essential and a necessary review of the CCP regulatory and supervisory framework.**

The active account requirement is aimed at addressing the substantial systemic nature of certain clearing services. However, it is not meant to address the risks linked to the exposures of EU clearing participants to Tier 2 CCPs, in particular in crisis situations. We believe that stronger cooperation arrangements and meaningful powers in the field of crisis management, as well as a revised approach to comparable compliance would help address concerns.

Second, the Commission's proposal rightly aims to address risks and vulnerabilities that we have identified throughout two almost consecutive crises. While the inner ring of the clearing ecosystem appears to have resisted well to the shocks that materialised, the same cannot always be said for the outer ring where clients have experienced difficulties in meeting abrupt and sudden margin calls resulting from price movements and increased volatility. While ESMA is making important progress in reviewing tools intended to limit the procyclical nature of CCP margin calls, the preparedness of clients remains essential. We believe that ongoing international work on anti-procyclicality, as well as the Commission's proposal to expand the margin simulation tools to the client clearing level, will go a long way in helping them prepare.

The recent energy crisis has also highlighted some tensions where financial and energy markets meet. The Market Correction Mechanism (MCM) Regulation has shown how issues in the underlying spot markets can end up as higher exposures in financial derivatives markets. Commodity markets, and in particular energy markets, have their own particularities, such as a strong proportion of non-financial counterparties (NFCs), but these specificities cannot come with weaker requirements. The proposed empowerment for ESMA to define what is expected in terms of admission criteria and ongoing membership requirements is in this regard welcome.

The Commission also clarifies in the EMIR 3 proposal that CCPs which offer clearing in both financial instruments and non-financial contracts should be subject to EMIR requirements in their entirety. We believe that similar activities that carry the same risks require the same regulatory treatment and, therefore, that the current EMIR approach should be extended to all non-financial contracts, such as forwards on certain commodities, regardless of whether a CCP also clears financial instruments.

We look forward to supporting the co-legislators in fine-tuning and improving the Commission proposal but would urge them not to turn a blind eye to the issues that we observe in our daily work.

JOHN BERRIGAN

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

Strengthening the Capital Markets Union: the Clearing Package

In December last year the European Commission put forward a package of measures to foster the Capital Markets Union (CMU), covering clearing, listing and corporate insolvency rules. Clearing is key for the success of the CMU: if it does not function properly, financial institutions, companies and investors face more risks and higher costs.

The proposed clearing package pursues 3 objectives. The first one is to have a competitive and modern clearing system in the EU: only well-developed and dynamic central counterparties (CCPs) can support trading in capital markets effectively. Second, it aims at increasing the safety and resilience of the EU clearing ecosystem, by strengthening the supervisory setting for EU CCPs and drawing some lessons from the recent stress events in energy markets. Third, the package supports the EU objectives in terms of open strategic autonomy. Clearing is a global business: that is why EMIR is an open framework and should remain so. But open strategic autonomy also means addressing the risks that can stem from excessive exposures by EU market participants to individual CCPs outside of the EU. Such a level of exposure, with no EU authority being in the driving seat in case of stress events, can pose risks to EU financial stability.

To these ends, the package includes amendments to the European Market Infrastructure Regulation (EMIR) and other pieces of EU law, and a Communication setting out the Commission's vision for central clearing in the EU for the years to come. To support a competitive and modern clearing system, the proposed measures streamline the administrative procedures EU CCPs have to go through when they want to launch a new product on the market. Currently, it can take up to 2 years for an EU CCP to get the supervisory approvals necessary to start offering a new clearing service. This needs to be fixed if EU CCPs are to be competitive internationally and to keep up with the increasing demand for clearing.

The package paves the way for a safer and more competitive EU clearing ecosystem in the future

On the supervisory side, the focus of the proposals is on improving monitoring and control of cross-border risks and strengthening the EU dimension of supervision. If clearing activities in the EU are to increase, it is even more important that the cross-border risks, which run across the clearing chain (CCPs - clearing members - clients) and across different Member States are properly supervised.

The recent energy crisis confirmed the importance of having the full picture of what is happening across the clearing chain. For this purpose the proposal includes, for example, a cross-border monitoring mechanism involving the European Supervisory Authorities, the European Central Bank, the Single Supervisory Mechanism, the European Systemic Risk Board and the Commission. It also establishes joint supervisory teams for EU CCPs under the lead of the national supervisor, building on the current supervisory system while promoting a more European approach to supervision on the field. As regards the lessons from the energy crisis, the proposal strengthens the transparency of CCPs' margin calls to help clients better predict such calls and the related liquidity needs.

To support the EU open strategic autonomy, the proposal requires market participants that are under the clearing obligation in EMIR to clear a portion of their derivatives through active accounts at EU CCPs. The derivatives targeted are those belonging to the clearing services of two UK CCPs that ESMA assessed as posing excessive risks to the EU: according to ESMA, these clearing services are of such substantial systemic importance that they could pose risks to the financial stability of the EU or of one or more of its Member States. So, the requirement for active accounts targets these financial stability risks and aims at reducing the excessive exposure of EU players to the UK CCPs. The calibration is left to ESMA, as it can access appropriate data, and needs to take into account properly any costs and impacts, in order to achieve a balanced result.

Finally, in the Communication accompanying the legislative measures the Commission encourages EU public entities that clear, or wish to clear, their transactions to do so at EU CCPs. This would give a signal of confidence in EU CCPs and support the aims of the CMU. Likewise, the Commission commits to clearing at EU CCPs where the offer is available.

This package can pave the way for a stronger, safer and more competitive clearing ecosystem in the EU for years to come. The impacts of the package do not depend only on making legislative changes, but also on the engagement and commitment by all actors involved, both public and private. Regulators and policymakers can set the conditions for an enhanced clearing landscape in the EU. But it is for market participants to take up the opportunities offered by regulation.

The Commission supports swift progress by the European Parliament and the Council towards the adoption of the measures and stands ready to facilitate the inter-institutional negotiations.

CLAUDINE HURMAN
Director of Innovation and Financial Marketing Infrastructures - Banque de France

Reducing EU dependency to offshore CCPs: the end of the beginning

Three years after Brexit, the EU clearing landscape is clearing up. After years of technical work, public consultations and policy discussions, the proposal for the review of the European Market Infrastructures Regulation (EMIR), published by the Commission last December, is a welcome decisive step towards the reduction of the overreliance of EU entities on third-country CCPs. It is, perhaps, the end of the beginning.

This long process was yet necessary to find a balanced answer to a complex and crucial question. A consensus has emerged among EU member states and market participants on the unsustainability of a status quo. The heavy concentration of euro interest rate and credit derivatives markets in two offshore CCPs has always raised important financial stability concerns, and Brexit sharpened these concerns for the EU. In the past years and up to very recently, markets' high volatility and margins' procyclicality have become a pain point and a liquidity issue. In the clearing field, it is true that the concentration of volumes is a factor of efficiency. However de-netting costs are temporary and can be overcome.

We have a living example with the progressive migration of the clearing of CDS from an offshore CCP to the continent, following a strategic business decision, with milestones set, no cliff-edge effect and market participants adapting to change. What can be done by the market through a business decision can also be achieved in other systemic clearing segments through regulatory incentives. We should not be afraid of this: it works.

And this is exactly what the Commission proposes: to endow the EU with a long-term strategy to progressively strengthen the EU clearing sector, while mitigating costs for market participants. This strategy relies on two pillars.

A roadmap to reach a balance between the objectives to pursue, which we must collectively seize.

The first pillar aims at giving the market a push to initiate a sustainable rebalancing of exposures. Past experience proves that such movement cannot be entirely market-led and voluntary: in spite of repeated calls from the EU authorities, migrations of trades to clearing in the EU have been limited, and the increase of EU CCPs' market share has been slow. It has even reversed since 2022 for OTC interest rate derivatives. This is notably due to the tension between the short-term costs of dividing the liquidity pool, and the long-term benefits of deconcentrating exposures. Therefore a decision is needed.

The Commission proposes to provide such a push by requiring EU market participants to hold a defined share of their activity on substantially systemic products in "active" accounts with EU CCPs. This requires quantitative targets to be achieved in order to reduce the systemicity of offshore clearing services. This requirement aims to decrease the level of reliance to offshore CCPs to a level that is acceptable for the EU from a financial stability standpoint. While this target level is still to be defined – on the basis of technical work to be conducted by ESMA in cooperation with EBA, EIOPA, the ESRB and the ESCB –, it can capitalise on the substantive work carried out in the past to assess such systemicity.

Reaching non-systemic levels for clearing in offshore CCPs is a final target, to be achieved by a gradual increase of the requirement. Such roadmap would allow to limit short-term costs, by initially setting the requirement at an ambitious yet sustainable level, and by also setting the final target. Prudential Pillar 2 measures are also there to ensure a consistent framework, to better reflect the assessment of risks related to excessive concentration in some CCPs as well as to ensure that risks are adequately covered by capital. This approach would also allow dynamic evolutions to smoothen long-term costs, by granting EU CCPs adequate time to enhance their offers, and to EU market participants to rebalance their activity and progressively increase the EU liquidity pool.

In order to complete the regulatory approach, the second pillar provides for measures to reinforce the clearing offer in the EU, by building up a polycentric clearing offer. It proposes to reduce the administrative burden on EU CCPs and their participants, for example by shortening and streamlining the procedures for validating CCPs' material projects, thus enhancing their ability to answer the needs of their clients. The build-up of this offer comes with an enhanced supervision, through a review of the EU supervisory framework, involving the extension of the assessment and validation powers of the supervisory Colleges and of ESMA. The unique EU cooperation framework for CCP supervision will be further enhanced to accompany the shift of clearing.

The Commission proposals provide a roadmap to reach a balance between the objectives to pursue, which we must collectively seize. This is a prerequisite for developing the infrastructures of the CMU, with a polycentric network of EU financial centres, and for achieving the strategic autonomy of the EU in the systemic clearing field.

DANIEL MAGUIRE

Head of Post Trade - LSEG & Group Chief Executive Officer - LCH

Supporting an attractive EU clearing ecosystem

As a global financial markets' infrastructure and data provider, LSEG is committed to supporting a healthy and resilient EU clearing ecosystem. Through our CCPs LCH Limited and LCH SA, we provide firms locally and globally with access to large pools of liquidity and solutions across asset classes, ensuring they benefit from our proven risk management capabilities.

At no time has the importance of access to cleared liquidity and robust risk management been more acute than during recent market events including tensions on Credit Suisse, the collapse of SVB, the Russian invasion of Ukraine, the UK 'mini budget', and the Covid pandemic.

Looking specifically at the EMIR proposals which are currently under review, we are supportive of the European Commission's objectives of making the EU clearing landscape more attractive and resilient, and broadening access to liquidity. As key players in that landscape, we support a more streamlined and harmonised EU supervisory framework, a more agile supervisory processes, and improved access to clearing for EU buy-side participants such as pension funds and insurance companies.

From a supervisory point of view, streamlining the approval process for new products and services and substantial changes to CCPs' risk models and parameters will help to address inefficiencies in the EU regulatory framework and increase the competitiveness and resilience of EU CCPs and their ecosystem. Faster approvals mean quicker adaptation to market demands, which in turn increases the competitiveness of EU CCPs and the attractiveness of the entire ecosystem. However, the current proposals have the potential to make the supervisory structure more complex by introducing new mechanisms and procedures. As such, we urge the co-legislators to consider a greater level of direct EU supervision, for example by the ESMA Supervisory Committee, to better address those complexities. We need more cooperation and streamlining, not replication and duplication. Further, an enhanced cooperation framework with third-country CCPs' supervisors is essential if financial stability concerns are to be addressed. Clear visibility for ESMA on recovery and resolution plans of tier 2 CCPs will be key to ensure transparency and trust in the ecosystem.

For EU firms, access to a global multicurrency CCP is essential.

From a market demand perspective, we fully agree that investment funds and insurance companies should benefit from reduced costs when using clearing services. The capital treatment of new access models, such as LCH's Sponsored Clearing for repos, needs to be clarified to further unlock clearing opportunities and provide broader access to liquidity for the buy-side.

Yet, while streamlining supervision and broadening access to central clearing can bring us closer to a more competitive and resilient clearing ecosystem, proposals that would reduce EU market participants' access to third country CCPs will drive us in the opposite direction. Requirements on EU firms to hold active accounts (with quantitative measures ascribed) in the EU are intended to improve the management of financial stability risks, but the contrary holds true; artificial fragmentation would disrupt a highly effective global derivatives market and damage EU firms', and by extension the EU real economy's, ability to access best priced liquidity and manage their risk in a safe and efficient manner, and on the same basis as non-EU firms and real economies. Furthermore, such measures would undermine the attractiveness of the Euro as a leading international reserve currency.

OTC derivatives markets are global by nature and the clearing services supporting these markets are global by nature too. This is the case for the Interest Rates Derivatives (IRD) markets. LCH SwapClear operates a global IRD clearing service in 27 currencies, of which the EUR is second to USD in terms of notional and risk registered. To put it into context, 70% of the EUR IRD notional registered at LCH's SwapClear originated outside the EU. For EU firms, access to a global multicurrency CCP is essential considering they tend to clear as much in non-EUR as in EUR, requiring access to global liquidity pools to hedge their risks and to service their customers in all currencies in an efficient manner. Doing so also supports financial stability and ensures the most comprehensive risk mitigation during severe stress periods, in line with the G20 objectives.

The EMIR proposals are moving in the right direction with regards to supervision, enabling broader access to central clearing, and increasing the competitiveness of EU CCPs. However, other requirements such as active accounts, if mandated, would undermine EU firms' ability to efficiently manage their risks, operate efficiently, and remain competitive in servicing their own customers. Failure to acknowledge these risks putting EU financial stability and competitiveness at risk.

ERIK TIM MÜLLER

Chief Executive Officer - Eurex Clearing

Building a more resilient and competitive EU clearing ecosystem

In the midst of a challenging macro-environment marked by geopolitical tensions, high inflation and low economic growth, it is critical that the EU continues its path of ensuring resilient and globally competitive financial markets and infrastructures.

Strong financial market infrastructures, such as central counterparties (CCPs), constitute the backbone of the Capital Markets Union and are an essential key ingredient for the EU's strategic autonomy. CCPs make a substantial contribution to the resilience of the EU's financial system through efficient risk management.

However, in addition to ongoing market-led efforts, targeted regulatory measures are necessary to further strengthen the EU clearing ecosystem in at least two critical dimensions: First, we need to ensure that clearing at EU CCPs becomes more attractive for market participants and more competitive in global comparison. Second, we need to guarantee that EU market participants do not remain overly reliant on off-shore markets and 3rd country CCPs, given that recent market events reemphasized the need to ensure financial stability while guaranteeing orderly monetary policy.

Against this background, I strongly welcome the European Commission's legislative proposal ("EMIR 3.0") to structurally strengthen the EU clearing ecosystem. In particular, I welcome that it requests market participants subject to the clearing obligation to maintain an active account at an EU CCP for systemically relevant products. Compared with other policy options that have been explored in protracted discussions over the last years, the active account approach is targeted and proportionate. It aims at rebalancing a proportion of clearing activities at Tier 2 UK CCPs into the EU to the extent that they are not considered systemically relevant anymore, whilst simultaneously allowing for flexibility to continue clearing in London. As such, it strikes a good balance between EU financial stability interests, the protection of EU taxpayers, and market participants' competitiveness concerns – helping the market to transition into a healthier environment with more competition and significantly reduced risk concentration.

Commission's proposal marks an important milestone paving the way towards an EU strategic autonomy.

If well calibrated and combined with clear guidance, such a requirement could lead to a more sustainable outcome where serious risks, notably around the Euro currency, are mitigated to a much higher degree. As regards the calibration, a risk-sensitive methodology paying due regard to EU dealers' activities around market making and non-EU client services would be appropriate. In addition, it is key to realise that many EU CCPs, including Eurex Clearing, do not charge account fees, meaning that even the smallest market participants can do so for free. In fact, Eurex Clearing continues its strong commitment towards a market-led solution, and therefore launched an additional incentivization programme that supports each individual buy-side customer with up to €50.000 just for setting up and using a second account – voluntarily and constructively supporting the shift of exposures from London to the EU.

Besides the active account, EMIR 3.0 also aims to address constraints that unnecessarily hold back the supply side of the EU clearing ecosystem. The streamlining of supervisory approval procedures for CCP services and products or risk model changes as well as the introduction of a 10-day non-objection procedure for non-significant changes are crucial elements in this respect. As the current regime has proven to hamper EU CCPs' time-to-market in global comparison, those changes will align the EU more closely with other jurisdictions. Clear and reduced timelines will not just benefit EU CCPs' competitiveness but also make a substantial contribution to the EU's strategic autonomy – given that new markets and new asset classes could in future also be based in the EU, fostering the international role of the Euro and boosting Euro-denominated markets with substantial supervision and enforcement rights for EU authorities.

Finally, the EMIR 3.0 proposal includes changes aimed at removing barriers to the use of central clearing by funds. These barriers arose as respective frameworks (e.g. UCITS, MMFR) did not take into account that CCPs would offer tailored solutions enabling non-banks to directly access CCPs. Especially the recognition of the risk-reducing nature of central clearing in funds' regulation by way of excluding cleared OTC derivatives transactions from counterparty risk limits is very helpful. Such clarifications will contribute to improved access options and greater diversification.

Overall, the Commission's proposal marks an important milestone paving the way towards an EU strategic autonomy. In light of a fragile macroeconomic environment, paired with a swiftly approaching expiry of UK CCP equivalence in summer 2025, it will now be critical to quickly implement EMIR 3.0, preserving its key building blocks to structurally boost the competitiveness of the EU's clearing ecosystem.

HAROUN BOUCHETA
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Ensuring the competitiveness of EU firms in the clearing space

In December 2022, the European Commission proposed a revised version of the European Market Infrastructure Regulation. Known as "EMIR 3.0", this proposal seeks to further enhance the competitiveness and attractiveness of EU CCPs. EMIR 3.0 includes measures to reduce what is considered by the Commission as being an excessive reliance of EU market participants on non-EU CCPs especially concerning euro-denominated IRS transactions on UK CCPs.

EMIR 3.0 is part of the broader Capital Markets Union (CMU) plan whereby the European Commission aims at (1) reinforcing the EU's global competitiveness and autonomy and (2) making the financial system more resilient so it can better adapt to the UK's departure from the EU.

With regard to EMIR 3.0, the careful framing of its proposals will be key to ensure that both objectives are met and that the EU clearing system is enhanced without the competitiveness of the EU financial institutions and clients being negatively impacted.

Given their global nature, any major regulatory measure on derivatives markets needs to be designed within a global coordination. The introduction of EMIR in 2012 has been considered a success notably because it has been agreed through the G20 and happened together with the introduction of similar regulations implemented in the other major jurisdictions. Even if EMIR 3.0 follows another way in terms of coordination, it is important to preserve the consistency of the global clearing framework across its evolutions.

The proposal introduces some useful improvements. EMIR 3.0 introduces useful and welcome improvements on various aspects: simplification of procedures for the authorization and recognition of smaller third-country CCPs, simplification for the extension and authorisation of EU CCPs activities and services, simplification of the mechanism for intragroup exemptions, eligibility of additional collateral such as bank guarantees and public guarantees and clearing exemption for third-country pension funds when exempted under their own rules.

The new version of EMIR should ensure that the EU clearing system is enhanced without the competitiveness of the EU financial institutions and clients being negatively impacted.

In addition, some requirements for clearing members and clients providing clearing services to ensure additional transparency and predictability of CCP models towards their clients should be regarded positively as well even though it would be useful to add in the regulation the same level of transparency requirements of CCPs vis-à-vis their clearing members. This would limit uncertainty for clients when CCPs need to urgently increase margin calls, especially on an intraday basis in time of crisis.

But there is a risk to create competitive disadvantages for EU firms. Two measures, though, might create competitive disadvantages for EU market participants: the proposed pillar 2 prudential measures and the active account proposal – depending on the way the second one is framed.

The pillar 2 prudential measures create an additional barrier to providing services to clients, which non-EU banks do not have. This means that EU banks will have their ability to provide services to non-EU clients curtailed.

The active account proposal would be a workable solution if it were designed as a qualitative requirement. However, if it imposes rigid quantitative thresholds, it would likely result into a spread between the EUR derivatives cleared at EU vs UK CCPs at the expense of EU clients and creates a major barrier for EU financial institutions to providing services to clients, which non-EU banks would not have.

For both the active account proposal and the pillar 2 prudential measures, the only way to ensure a level playing field between EU and non-EU clients and financial institutions would be to carefully calibrate any active account requirements and logically exclude from its scope non-EU clients and EU clients not subject to EMIR.

The process to recognise third-country CCPs would be improved . EMIR 3.0 also deals with issues related to third-country CCPs. Recent events have shown how important this question is. One example can be given by the de-recognition of Indian CCPs by ESMA with its detrimental impacts for EU players.

In the proposal, additional tools for the Commission and ESMA are proposed to be added to manage equivalence to EMIR and recognition of third-country CCPs. It is an improvement as long as it provides more flexibility for the Commission and ESMA to move forward in the recognition process without unduly penalising EU firms.

The Commission would have the possibility to grant an equivalence even if the third-country does not include a recognition regime similar to the EU one. In addition, powers of ESMA would be extended notably to provide more time for third-country CCPs to take the relevant remedial actions and to issue public notice if needed.

The future of EU clearing. The complex and global nature of derivatives markets has to be taken into account in this EMIR 3.0 proposal. Statistics indicate that the clearing of USD denominated IRS mostly takes place outside of the US because firms and their clients need to access to larger liquidity pools to be able to achieve cross-currency netting.

It shows that it remains complicated to predict how EMIR could change the structure of these liquidity pools but in any case it is of mere importance to better take into account the impact of the regulation on the competitiveness of EU firms and their clients.

GIUSEPPE GRANDE

Deputy Head of Market and Payment Systems Oversight - Banca d'Italia

The energy crisis in Europe and CCP margins

The extraordinary measures recently taken for energy and commodity derivatives must be read in the context of what happened in the global energy markets in 2022. After Russia's invasion of Ukraine at the end of February, prices skyrocketed. The shock was particularly severe in the European gas market, where prices jumped tenfold over the ten-year pre-war average, exceeding €340 megawatt hours (MWh) at the end of August. In Europe, the jump in energy prices fuelled fears of energy supply disruptions and market manipulation. It immediately had geopolitical and macroeconomic repercussions, the first of which was a rise in inflation.

In the energy derivatives markets, Central Counterparty (CCP) margins increased, and this created liquidity strains for non-financial corporations (NFCs), because NFCs typically have fewer assets and less liquidity, and thus the increase in margins forced them to reduce their positions or remain inadequately hedged.

In this context, at the request of the European Commission to facilitate the provision of collateral by non-financial counterparties that are active on gas and electricity markets cleared in EU-based CCPs, last autumn ESMA introduced a temporary, twelve-month extension of the collateral pool to public guarantees for financial and non-financial counterparties and to uncollateralised bank guarantees for NFCs acting as clearing members. In addition, on 20 December 2022, EU energy ministers reached a political agreement on a market correction mechanism (MCM) capping gas prices. The regulation entered into force on 15 February 2023 and will apply for one year.

These temporary measures are designed to respond to unprecedented stress conditions that are systemically relevant. The extension of collateral increases the ability of banks to provide liquidity to their customers and allows NFCs acting as clearing members to post unsecured bank guarantees. As for the MCM, it is an instrument against episodes of excessively high gas prices. It is appropriately set at a historically very high level and is dynamic in that it has a variable component defined as a €35 spread on the price of liquefied natural gas (which, unlike pipeline gas, is traded worldwide and whose price can therefore serve as a benchmark for global price developments).

Extending collateral, increasing the transparency of margins and mitigating their procyclicality.

The effects of the MCM are closely monitored in order to prevent any unintended market disturbances. According to ESMA, so far the MCM does not appear to have had any significant effect on prices, trading activity, liquidity and execution (i.e. change of trading venue) of gas trades. Furthermore, there have been no significant changes in CCP risk management or margin requirements that can be attributed to the MCM. However, too short a period has elapsed since its entry into force.

A worrying sign is that two exchanges (ICE Endex and EEX) have announced that they will also offer trading in gas derivatives on two trading venues outside the scope of MCM regulation. Any trade dislocation would be undesirable from a regulatory perspective, as it would be inconsistent with the objective of further developing European capital markets and would hinder financial supervision.

Temporary measures can help manage crisis situations, but structural ones can ensure more efficient and secure outcomes. The EC's proposal to revise the EMIR regulation (EMIR 3) seeks to address this need. Among other things, the proposal provides that bank collateral can be considered eligible as highly liquid collateral by CCPs, irrespective of whether it is posted by financial or non-financial counterparties, but provided that it is unconditionally available upon request. The proposal also allows firms to better understand their potential future liquidity needs in the instance of central clearing by requiring margin models to be more transparent for all. The amendment to strengthen the requirements for participation in a CCP entails that the NFCs that have direct access to a CCP will have to be better equipped to comply with such requirements.

Recent developments in EU energy derivatives markets have once again highlighted how insidious the risk of CCP margins being procyclical is, as they themselves may cause asset price volatility. The commitment of regulators to tackle the problem is evidenced by the recent work of ESMA and BCBS-CPMI-IOSCO. The lines of action cover a range of topics: the role played by the membership structure (in particular, the types of clients served by clearing members, and how the latter demand margins from the former), the metrics to evaluate the excess of procyclicality, its drivers, transparency to clearing members and clients, reports to the authorities, and the CCPs' risk models and containment strategies.

To make progress in the development of anti-procyclicality tools it is essential to keep CCPs, the clearing members and their clients as involved as possible. Their insights are key to understanding which aspects deserve more attention and which solutions work in practice.

SUYASH PALIWAL

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New challenges we face together

As the aphorism goes, history does not repeat itself, but often rhymes. We frequently talk about extreme incidents as 1-in-100-year events, but lately, they seem to happen every other year.

Last year, Russia invaded Ukraine. The extent of the devastation continues to unfold, but we can identify significant impacts on the financial system. Commodities markets experienced high volatility and price levels. The cleared derivatives system fared well and functioned as designed. Margin was called and paid. Price risk was efficiently and transparently shifted, and price discovery occurred.

In 2020, the pandemic gripped the world. Equity markets faced unprecedented volatility, yet, here also the derivatives system met the challenge.

These live, global, extreme-but-real stress tests vetted the post-crisis G20 reforms, demonstrating the resilience and endurance of the derivatives architecture. But, strains felt by market participants threw light upon areas ripe for a fresh look by regulators. Last year, we also saw startling events in digital assets, including the collapse of FTX. This sharpened regulators' focus on digital innovations, which continue to reshape the financial sector.

These topics, and an array of domestic issues, are top-of-mind for the US Commodity Futures Trading Commission (CFTC) in its exercise of authority over commodity and other derivatives markets.

Forewarned is forearmed

Margin is among the cornerstones of the derivatives architecture, and as a critical component of derivatives risk management, it has been a consistent topic of international discussion. When the volatility induced by the pandemic was at its peak in March 2020, derivatives margin, while functioning as designed and being paid, came into sharp focus. High margin calls prompted many to ask questions about how the derivatives ecosystem works. What are the potential impacts of margin's operations, the strains it can put on institutions, and tradeoffs inherent in providing and obtaining liquidity?

Since 2020, IOSCO, CPMI, and the BCBS have collaborated on a data-driven exercise to understand margin dynamics and liquidity impacts in March 2020. The CFTC continues to engage substantially, co-chairing the project with the Bank of England and working with experts from the ECB, ESMA, and leading EU national competent authorities, among others.

> **FTX's swift decline into insolvency last year stunned the financial sector.**

Whether this prompts substantial change to a system that worked remains to be seen, and one-size-fits-all adjustments may not always be wise. Still, enhancing the preparedness of market participants so that they are forewarned of derivatives margin calls could benefit the system. To promote preparedness, we could seek to sustain or enhance transparency by those issuing margin calls, including central counterparties (CCPs) and intermediaries. And we may identify steps that market participants could take to foster a clear understanding of margin's responsiveness to market volatility and price levels.

Bankruptcy happened gradually, then suddenly

FTX's swift decline into insolvency last year stunned the financial sector. It also underscored the need for an effective regulatory perimeter and appropriate policy responses to protect customers and address the extant and growing risks in the digital asset space.

In the US, traded underlying assets are typically considered securities or commodities. Where digital assets are treated as commodities—an expansive term under US law—and not securities, they fall in a lacuna of US regulatory coverage: there is no US spot-market regulator for digital commodities. The CFTC has long been calling on the US Congress for authority over digital asset spot markets. If granted the authority, the CFTC could leverage its existing regulatory framework, which is grounded in risk management and market integrity, to effectively oversee these markets and better protect customers and the public. Relevant protections could include mitigation of conflicts of interest, customer fund segregation, governance and corporate controls, and other enhanced customer protections.

The home front

Here at home, the CFTC's domestic regulatory agenda continues at full throttle, including possible rulemaking on:

1. enhancing risk management and resilience across intermediaries, exchanges, and CCPs;
2. fostering sound and responsive practices on cybersecurity and the use of third-party vendors across all registrants;
3. strengthening customer protections;
4. promoting efficiency and innovation;
5. improving reporting and data policy; and
6. addressing any duplicative regulatory requirements and amplifying international comity and domestic coordination with both US federal and state regulators.

Looking ahead

New risks continue to arise at least as fast as the regulators address them. But optimism lies ahead in what we can achieve through sound regulation and cross-border cooperation. So when – and not if – history rhymes again, we are confident that the system will again demonstrate resilience.