IMPLEMENTATION OF EMIR 2.2

1. Key elements of EMIR 2.2 and next steps

A Central Bank official explained that EMIR 2.2 aims at ensuring financial stability in the field of central clearing and addresses two main issues. First, EMIR aims to foster the convergence of CCP supervision in order to prevent regulatory arbitrage and mitigate any cross-border spill-over effects from the potential failure of such an entity. The compromise reached with the new regulation allocates responsibilities amongst national competent authorities (NCAs), Central Banks of issue (CBIs) and ESMA, which is granted new powers with the establishment of a new supervisory committee. Second, it creates a proportionate, risk-based approach for third-country CCP supervision with additional requirements for CCPs that are systemically relevant to the EU. The EMIR 2.2 trialogues are now over and the legislative text is finalized. The European Parliament will be voting on the final text around mid-April, to be endorsed by the Council shortly after. The challenge now is to ensure the effective and smooth implementation of the new regulation, and the swift adoption of the technical standards. This should be complete by October 2019.

Another Central Bank official agreed that achieving higher consistency and coordination among EU regulators and on regulatory practices is essential in this area, given the importance of CCPs for the stability of the European financial sector and in view of the increasing interconnectivity of the financial system. Another important element of the EMIR 2.2 legislation is the acknowledgement of fiscal responsibility at the national level. Third-country CCPs will have a centralised supervisory recognition regime, with ESMA at the head of the system and also an increased role for Central Banks of issue (CBIs). For EU-based CCPs, the NCAs will continue to play the most important role, but nevertheless the CBIs and ESMA are strengthened in their roles and activities. Colleges now see more space for their opinions also, and the possibility to deliver ad hoc specific recommendations. The new setup has more transparency also regarding the composition and the workplan of colleges.

2. Expected impact of EMIR 2.2 on cross-border EU CCP supervisory processes

A regulator considered that there are only marginal changes for EU CCPs compared to the current EMIR environment. The ultimate supervision responsibility will remain with the NCAs in charge. There is a wider role for colleges, particularly concerning shareholder changes and outsourcing. There is also an obligation for NCAs to ask opinions from ESMA in certain areas, such as authorisation and access requests from trading venues and NCAs can ask ESMA for views in other areas. In terms of governance, the decision-making will remain with the ESMA Board of Supervisors, but there will be a new supervision committee under the Board of Supervisors taking charge both of the EU CCP supervision work, and the third-country supervision work.

A Central Bank official noted that the negotiation of the allocation of responsibilities and decision-making powers between CBIs, securities regulator, ESMA and others had been complex and that there is probably still room for improvement and mutual learning regarding supervisory practices. There is a trade-off between the cost of compliance for regulated entities, and the cost of supervision from the authorities' side, which is increasing. This has already been seen under EMIR 1. There is a learning process from the authorities' side, therefore conclusions on the effectiveness of this new process will need to be drawn in a few years' time.

In addition, whilst the tiering criteria for third-country CCPs are welcome, there is a gap in that all EU CCPs are considered systemically important under EMIR 2.2, the official emphasized. Therefore the same measures are applied to EU CCPs whatever their size, the currencies they deal in, or their shareholding or customer base. It is however difficult to say that all EU CCPs have the same risk profile.

An industry representative regretted that almost nothing will change regarding the supervision of EU CCPs and considered EMIR 2.2 as a missed opportunity in that area. In the end the authorisation and decision-making processes will remain with the NCAs, even if ESMA and the CBIs are consulted on some aspects. The negotiation took place in the very specific context of Brexit, but Europe needs to be globally more ambitious in the promotion of supervisory convergence. Credibility at the international level is important, and if ESMA cannot speak with a united voice and represent the interests of EU member states, this is problematic. Regarding the implementation phase, it is necessary to clarify a number of aspects, notably concerning clearing members, and the Level 2 measures will be helpful in this regard.

Another Central Bank official believed that the fact that changes are limited with the new regulation for EU CCPs is the result of a compromise. There should however be an improvement of cooperation, convergence and consistency in supervision, which will become more apparent after implementation, meaning that the new regulation is more positive than it may appear. Following a question from the audience about whether Central Banks should supervise clearing houses, the official indicated that the ECB has withdrawn its recommendation to modify Article 22, meaning it will no longer ask for a supervisory role on clearing houses, and have only a consultative role.

3. Issues to be considered regarding EMIR 2.2 requirements for third-country CCPs

3.1. EMIR 2.2 objectives regarding third-country CCPs and next steps

A regulator felt that that the adoption of EMIR 2.2 in the current legislative period is a positive result, given upcoming changes. While EMIR 1 introduced a very open equivalence system for allowing access to the EU market for third-country CCPs, the potential risks to the EU market from these CCPs are not appropriately reflected. Improvements will be made in EMIR 2.2, particularly regarding systemically important third-country CCPs, the so-called tier 2 CCPs. It is important to emphasize however that EMIR 2.2 provides a proportionate regime, distinguishing between third-country CCPs which are systemically important, and the vast majority of (non-systemic) third-country CCPs which will effectively remain under the same regime as at present. The new regime provides the European authorities with more powers to monitor tier 2 CCPs and to ensure compliance with EU requirements where necessary. This will make it possible to mitigate systemic risks, and will create a level playing field with EU CCPs. Additionally, EMIR 2.2 offers the possibility to consider the relocation of substantially systemic CCPs as a last resort, following potential recommendations from ESMA and the relevant CBI to the Commission.

The regulator stressed that the next steps are for ESMA to provide the Commission with advice for drafting the relevant delegated acts notably in two areas: the tiering criteria needed to determine tier 2 third-country CCPs (those of systemic importance for the EU) and how third-countries may in practice achieve comparable compliance with the EU regulatory framework. There are many on-going bilateral conversations and consultations with stakeholders to get that right. In the EMIR 2.2 delegated acts there is also a need to define the level of visibility that ESMA needs in order to ensure that third-country CCPs meet all necessary requirements. The maximum amount of deference achievable will be looked for. EMIR 1 already had complete reliance on the third-country regulator, but with comparable compliance the individual areas on which deference applies will have to be looked at in greater detail.

A Central Bank official considered that the main change with EMIR 2.2 is that under EMIR 1 there is de facto no supervision at all of third-country CCPs by the EU authorities, only a high-level exchange of information. Now, in view of Brexit and of the expected higher complexity of the financial environment, a recognition and supervisory regime is being implemented, involving ESMA and CBIs in the EU, in a much more effective way than was the case before.

An industry representative emphasized that the whole EMIR 2.2 legislation effectively concerns only a handful of CCPs that will come into tier 2, since the others will continue to apply EMIR 1. The core justification of EMIR 2.2 is that CCPs may have a meaningful impact on financial stability within the EU. However, those same CCPs may have a greater impact on financial stability in their own home jurisdictions. It is therefore unlikely that a third-country CCP would pose such a threat to the EU when it did not pose a similar or greater threat in its own jurisdiction.

Another industry representative noted that EMIR 2.2 provides the EU authorities with a toolbox that should be used in a proportionate way, based on the perceived systemic importance of a third-country CCP to the EU. The toolbox includes direct supervision by ESMA, comparable compliance, etc. Other tools include third-country CCP colleges, Central Bank accounts from CBIs, and ex-ante MoUs (memoranda of understanding). It is important to ensure an equilibrium between ESMA/ECB roles and the home regulator's one. We need effective and predictable decision-making but also some flexibility. Cooperation needs to allow proportionate oversight, predictability and avoid regulatory arbitrage. Only then will we have a robust framework to address financial stability.

The first industry representative noted that the way in which this text will be implemented and executed is key, for the EU, third-country CCPs and markets in general, because a poorly-executed EMIR 2.2 could be very problematic.

3.2. Allocation of supervisory responsibilities and cooperation among supervisors

A Central Bank official noted that the G20, over many years, has recognised that resilient market infrastructures deliver real benefits to global markets both from a financial stability and efficiency perspective. With clearing houses the benefits grow with scale. As a CCP provides services in more currencies and jurisdictions the benefits tend to grow. However, as this happens, an increasing number of regulatory authorities are concerned, with a valid interest in having insight and input into the supervision and resilience of these CCPs. This has been very much reflected in the UK supervisory approach for some years in terms of bilateral supervisory processes or college arrangements. A key part of those arrangements has always been to recognise the ultimate accountability of the home supervisor. The thrust within the EU to strengthen the supervision of third-country CCPs is understandable, but it must be a pragmatic and practical approach and work within both the EU and the third-country in order to support cross-border business.

Some obligations of the agreed EMIR 2.2 text appear to compromise the powers of the home authority and threaten the home authority's discretion, the official believed, and a better understanding is needed as to how it will work in practice. In addition, some of the obligations placed on third-country CCPs go beyond those placed on EU CCPs. For example CBIs within the EU potentially have the ability to place unspecified requirements, in exceptional circumstances, directly on third-country CCPs, which gives CBIs within the EU powers over non-EU CCPs that they do not have over EU CCPs. With EMIR 2.2 third-country authorities are also being asked to commit to assure the enforcement of decisions made by ESMA, which could potentially fetter the legal responsibilities and discretions of the third-country authority and the CCP's own risk management, depending on how this is implemented. A key tool to avoid that and the potentially related conflicts of law is the provision of the CBIs with powers in terms of comparable compliance. This is catered for in the EMIR 2.2 text, but with no detail yet fleshed out on how it will work and it will be important to understand how this can work and address some of the points mentioned previously. When the UK becomes a third-country authority, its authorities will need to assess whether these clauses can work in practice, because if not, the costs and risks will potentially be significant.

A present there are strong working relationships between the UK and EU and Eurozone authorities, the official considered, on which it should be possible to build trust going forward. It is important however that competent authorities like ESMA and the ECB are given the flexibility to implement requirements in a pragmatic way. EU third-country requirements also need to be consistent with international standards.

A regulator believed there is a commitment from all sides to make EMIR 2.2 work. Nobody has an interest in creating an environment where authorities are working against each other. This cooperation needs to be the driving force. ESMA is committed to its new role and responsibilities and to build on existing strong ties to make global CCP supervision work. Part of this will involve formally looking at the existing MoUs and making sure that they are fit for the new regime.

In terms of practical implementation, an industry representative was encouraged by the general tone of cooperation between the EU, the UK and the US. However, there is still a great deal of work to be done. The two key elements are proportionality and cooperation. Proportionality is about striking the right balance for third-country CCPs in terms of supervision between ESMA, the ECB and the home regulator. It is also necessary to prevent duplication and confusion. This involves implementing regulations in a sufficiently harmonised and coordinated way at the international level, as many CCPs deemed systemic are global in nature. Effective coordination is needed between supervisory authorities, with defined responsibilities and powers for the CCPs. The more that can be defined up front the better in order to achieve efficient and effective decision-making in difficult times, however it is a delicate balancing act to also offer the level of flexibility needed to operate in different kinds of environment. Regarding cooperation, there is a longstanding experience of coordination among supervisors in this area. This cooperation should however not be limited to the EU and the UK but should also involve the US and other G20 jurisdictions as well. Cooperation has to deliver four elements which are the objectives of supervisors and also of CCPs: proportional oversight; predictable outcomes; prevention of duplication and of regulatory arbitrage; and a robust framework capable of addressing inherent systemic risks, and enhancing the financial stability of the markets.

Another regulator considered that EMIR 2.2 has landed "in a very odd way" concerning third-country CCPs. They will face a very different regime from EU CCPs, which has led to some strange results, such as ESMA's exclusive responsibility for third-country CCPs, and the fact that ESMA will be funded through fees charged to third-country CCPs. If not applied properly this could result in regulatory conflict. Another regulator clarified that in terms of fees the work that ESMA does regarding EU CCPs, as with any other supervisory convergence work, is paid for via a mixture of EU budget and NCA contributions. Anything where ESMA has direct supervision responsibilities, as applies to third-country CCPs, is directly charged to the relevant supervised entities. This is the same for credit rating agencies (CRAs) and trade repositories, so there is consistency in this approach.

Another industry representative noted that everyone now agrees that effective cooperation and coordination between supervisors across jurisdictions will be crucial. This will be very positive for the supervision of global cross-border CCPs, but it should be applied in other areas as well. A key concern on the part of clearing members is about the preservation of a level playing field for European clearing members in case of relocation of some clearing activities into Europe. Looking at EMIR 2.2, this is not guaranteed at all. It is essential that in the end EU clearing members are not penalised by the new framework compared to their non-EU competitors. If this is the case the only choice would be for them to exit this business, which would have negative consequences for competition and investors in the end.

3.3. Recognition of existing arrangements with the US

A regulator regretted that EMIR 2.2 does not sufficiently acknowledge the 2016 agreement between the EU and the US CFTC, which leads to the question of whether there is certainty regarding how comparable compliance will be applied. The fact that US CCPs will be forced to reapply for recognition decisions, with even those granted recently being reopened, with no sense of how they would be reassessed, is a concern for the US. On the positive side however is the timing. The application of EMIR 2.2 to third-country CCPs, especially US ones, will take several years, so there is sufficient time for supervisors to speak to one another and find solutions. There was a pledge by the EU and US authorities when EMIR 2.2 was agreed to ensure that EMIR 2.2 is implemented in such a way that it is effective for both jurisdictions, alongside an expectation that the outcome will lead to greater deference between the two jurisdictions. If this commitment can be kept, it is a result that everyone can agree on. The US has already announced a desire to make changes to its own regime, including in the area of CCPs, which it is hoped will address many of the concerns previously voiced by the EU. Hopefully this will lead to a more cooperative relationship on CCP supervision in particular.

The regulator added that there are many parts of EMIR 2.2 that have generated concern from the US perspective from the start. These include the fact that EMIR 2.2 does not take the same approach as the US does to non-US CCPs, the fact that EMIR 2.2 does not acknowledge the different treatment between exchange rate derivatives, futures products and swap products, and the fact that EMIR 2.2 does not limit itself to the EU-facing business of a CCP, but rather tries to assert EU authority over the global business. Finally, there is a lack of clarity on what constitutes a tier 2 CCP. This will cause third-country authorities anxiety unless it is defined in greater detail.

A Central Bank official felt that the new EMIR 2.2 regulation is very much inspired by the US, and with the new proposals made by the US there can be an evolution towards a more cooperative model, and greater deference in the future.

4. Steps taken regarding CCPs to avoid potential cliff-edge risks of a no-deal Brexit

A Central Bank official stressed that the EU and the UK authorities have put measures in place to mitigate the potential cliff-edge effect of a no-deal Brexit. In December, the European Commission temporarily recognised the UK legislative framework as equivalent to the EU's, on the condition of an appropriate exchange of information between authorities. Since then, an MoU has been signed between the Bank of England and ESMA, and ESMA has recognised UK CCPs to serve the EU market, which is positive. These preparatory measures taken by the authorities should facilitate the transition to Brexit.

Another Central Bank official agreed that the temporary equivalence decision and supporting recognition decisions on UK CCPs and CSDs were key steps to avoid cliff-edge risks. Contractual continuity in cleared markets has been highlighted by the UK authorities as one of the highest risks to financial stability stemming from a cliff-edge Brexit, posing risks to the UK and the EU. This is why in December 2017 the Bank of England announced its recognition process for non-UK CCPs, including a temporary recognition regime to ensure cliff-edge risks can be appropriately dealt with. The Commission's announcement in December 2018, that they had found the UK clearing regime equivalent on a temporary basis was welcomed, as was ESMA's swift action to agree to an MoU and recognise UK CCPs. This deals with a very significant potential cliff-edge risk. Those decisions, however, last only until March 2020. It is important that there should be clarity over what will provide continuity of access after that point. EMIR 2.2 is nearing finalisation, but there are many steps to go before having UK-based CCPs recognised under EMIR 2.2. Finally, from a broader Brexit perspective, there are other areas where material cliff-edge risks, albeit potentially less significant than for cleared derivatives, have not been dealt with, such as uncleared derivatives, trading obligations or data. This could be effectively addressed by further equivalence decisions, and clearing has provided a template that can be used in these areas. It is important though, that these remain technical, outcome-based decisions.

An industry representative agreed that much progress has been made in ensuring temporary recognition for CCPs and that this should be extended to trading, as potential cost increases for on-shore EU investors trading offshore and vice versa would hit EU investors first. Relevant authorities should act on trading equivalence, as it is very simple and in everybody's interests.

A regulator noted that the focus of the public authorities on clearing was justified by the risks involved in derivatives clearing and the need to ensure continuity in this area. This is why it was implemented, with the Commission's equivalence decision and the follow-up from ESMA on MoUs and recognition decisions. The final Brexit scenario will help to create more clarity about how the current temporary equivalence regime moves into the medium/long-term solution of EMIR 2.2.