Implementation of EMIR 2.2

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The preparation of EMIR 2.2. is well advanced and must be completed as soon as possible

The discussions relating to the EMIR 2.2. proposals (relating to CCP supervision) have been ongoing for the last twenty months. The goal of the European regulators is now to have EMIR 2.2 adopted by the next European elections in May 2019. A number of aspects have already been settled but the allocation of responsibilities among supervisors and the related and decision-making processes between is still pending. The key question underlying this allocation is to which degree ESMA should intervene in the decision-making process.

For EU CCPs, there is a consensus that their supervision should be centralized to some extent. First, preventing any form of regulatory arbitrage is a prerequisite for the building a genuine Capital Markets Union in the EU, or at least enhancing further the integration of European financial markets. In this perspective, the centralization of the supervision of EU CCPs is viewed as an essential step, because on-going differences between national supervisory practices are compromising the level playing field among EU CCPs. In addition, further harmonization of supervision rules seems all the more warranted as a failure of a given EU CCP may have large spill over effects across markets and jurisdictions. Following the subsidiarity principle, any issue that concerns the EU as a whole should be treated at the European level. Against this background, a key pending question is to which extent the supervision of EU CCPs should be centralized. ESMA should be granted indeed with more powers in the related supervisory process. The establishment of a dedicated Supervisory Committee for EU CCPs is a welcome step in this regard but the devil is in the details.

> *"A key pending question is to which extent the supervision of EU CCPs should be centralized."*
>
> \- NATHALIE AUFAUVRE

Such a Supervisory Committee will be useful only if ESMA is given a lead role in fostering the convergence of supervisory practices. In addition, concerned central banks should remain involved in the supervision process to ensure that all relevant standpoints are taken into account for a proper assessment, in accordance with the spirit of the >>>

>>> EMIR college setup which has proved effective in this regard. In practice, we may expect ESMA to pay special attention to the protection of the EU financial system as a whole from excessive exposures of clearing members to third-country CCPs. With respect to European currencies-denominated transactions, central banks of issue would look more specifically into issues relating to liquidity, collateral management and settlement issues relating to their currency.

Regarding the operation of third country CCPs, near term measures have been enforced with the aim to avoid potential cliff-edge effects relating to a no-deal Brexit. The European Commission has indeed adopted a delegated act determining for one year after the Brexit that the regulatory framework applicable to UK CCPs is equivalent to the EU's one in case of the absence of a deal. ESMA and the Bank of England have agreed Memoranda of Understanding (MoUs) regarding cooperation and information-sharing arrangements with respect to CCPs. During this phase of intense preparation, the European authorities have demonstrated their ability to adapt swiftly and cooperate effectively in order to avoid the disruption of financial processes and maintain business continuity and financial stability on both sides of the Channel after the Brexit.

From a longer-term perspective, the proposal under discussion is to follow a three-tiered approach for the supervision of third-country CCPs, which in particular provides an enhanced supervision for the systemically important CCPs and even a location requirement for the most important one. While the operational features of such a framework require close attention and have to be worked out further, the good news is that a consensus has already been reached on the principle of this risk-based approach, which depends on the CCPs' systemic importance to the EU financial system. This is in my view a major step forward deserving a strong and clear support from all stakeholders insofar as it will help avoid the mismanagement or facilitate the mitigation, if not prevent the occurrence, of crisis situations in the EU stemming from the demise of third country CCPs. ●

Verena Ross

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EMIR 2.2: it is time for implementation

The EMIR 2.2 legislative proposal was adopted and published by the European Commission in June 2017. Since then the EU Institutions, notably the European Parliament and the Council, have made significant efforts to analyse and negotiate this very important piece of financial market legislation. It is expected that the political agreement on the final text will be struck by the end of March 2019.

ESMA welcomes this progress, especially in light of the main objectives of this legislative proposal - ensuring financial stability through EU-level oversight over critical international financial infrastructures.

Under the new legislation, ESMA would have an enhanced role in monitoring recognised Third Country Central Counterparties (TC-CCPs). In particular for those that are determined to be systemically important TC CCPs (Tier 2 CCPs) ESMA would be assigned some direct supervisory tasks. The new legislation also recognises the important involvement of relevant Central Banks of Issue (CBI) in important decisions on Tier 2 CCPs.

"ESMA's priority is to ensure its operational supervisory capacity once EMIR 2.2 becomes applicable."

\- VERENA ROSS

Regarding EU CCPs oversight, the role of ESMA has been enhanced with the inclusion of a consultation process, under which ESMA has to provide its opinion on decisions to be taken by a national competent authorities (NCAs) in a number of areas. While the number of areas where ESMA consent is needed has been reduced, compared to the original Commission proposal, the involvement of ESMA has been overall broadened compared to today, which should >>>

>>> enhance supervisory convergence in the future.

Once the legislative process is completed, and the final legislative text published, ESMA will proceed with contributing to the relevant Level 2 measures under EMIR 2.2. In particular, its technical advice to the Commission for the delegated acts specifying the TC CCPs tiering criteria and how to conduct the assessment for "comparable compliance". Both areas have been identified as of significant importance already at earlier stages of the legislative process, therefore ESMA will pay particular attention to the right calibration and carry out extensive public consultations.

The other important priority for ESMA is to ensure its operational supervisory capacity at the time EMIR 2.2 becomes fully applicable. While ESMA is progressing with its internal preparations and planning, a crucial aspect to be ensured is the timeliness of additional resources to be granted to ESMA for the new tasks foreseen under the EMIR 2.2. In this respect, funding by industry fees is key in order to fulfil the legislative requirements.

ESMA will continue its close cooperation with the regulators and supervisors involved with CCPs around the globe. We are committed to build further on the existing cooperation arrangements and MoUs, taking into account ESMA's additional tasks and competences under EMIR 2.2.

Finally, regarding the relevant governance arrangements, the Parliament and the Council have decided to maintain the Board of Supervisors as the ultimate decision-making body of ESMA, and to create a more specialised new Supervisory Committee. ESMA will need to be operationalise the establishment of this new committee over the next months. ●

Daniel Maguire

Chief Executive Officer, LCH Group

Regulatory supervision and cooperation across jurisdictions – The way forward

The temporary recognition of UK CCPs by ESMA and non-UK CCPs by the Bank of England in case of a "no-deal" Brexit was well received by market participants and authorities across the globe. The decisions are in line with calls from the G20, the IMF and the FSB to address liquidity fragmentation and associated risks and vulnerabilities. They provide financial markets and their participants with important legal certainty to continue accessing effective risk management practices and preserve financial stability.

Regulators across the globe must now shift the discussion to ensure that, on a longer-term basis, open, globally interconnected and unfragmented markets are preserved. Only then can participants, and ultimately national economies, benefit from global and resilient markets post-Brexit. In the UK, the BoE intends to recognise non-UK CCPs within the three years temporary recognition period. In the EU, the full implementation of EMIR 2.2 should introduce an enhanced third-country regime that will enable a discussion around the recognition of third-country CCPs on a permanent basis.

End-users in the real economy need access to global pools of liquidity in both their local and foreign currencies, whether they are established in the UK, EU, the US or elsewhere, to hedge their risks and benefit from extensive clearing and risk management efficiencies. They should not be facing liquidity fragmentation, which is associated with increased risk and decreased market efficiencies and inevitably result in higher costs borne by the end-users whose money is invested in the hedging tools that are critical to the smooth operation of the real economy. It is of paramount importance that cross-border regulatory architecture preserves efficient access to all real economy hedging markets tools and liquidity.

In line with the IMF recent reports, G20 Declarations and FSB recent statements, the market should avoid regulatory driven liquidity fragmentation and build on regulatory cooperation to ensure a coordinated supervision of global operators. Safe and resilient markets need a diversified membership with global pools of liquidity and the corresponding regulatory input. Going forward, regulatory initiatives should build on existing global cooperation and supervision enabling market participants to operate without limitations in a safe and robust environment.

Today, our CCPs on both sides of the Channel are subject to extensive supervisory input as they are directly regulated by several authorities across the globe, in addition to their home supervisors. In the EU, EMIR 2.2 should provide EU authorities and central banks of issue with the appropriate level of assurances to monitor international pools of liquidity. It should also introduce a workable equilibrium between a proportionate EU supervision and home and other regulators' supervision. This supervisory model has worked effectively in the past and allowed the construction of a comprehensive and well-functioning supervisory framework for CCPs.

> *"Supervisory solutions should maintain financial stability, regardless of borders."*
>
> \- DANIEL MAGUIRE

The future landscape should be shaped by market choice, healthy competition and avoid creating unnecessary financial stability risks that could destabilise global markets. The short-term issues have been addressed. It is now time to implement a longer-term solution for the supervision of global pools of liquidity that will maintain financial stability, regardless of borders. ●

Eric J. Pan

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Building bridges and not barriers

The views expressed in this article are the personal views of the author and do not necessarily reflect the views of the CFTC staff, the CFTC Commissioners, or the US government.

A year ago, I had the privilege of addressing Eurofi on the topic of central clearinghouse (CCP) supervision. At the time, I noted that efficient and vibrant cross-border financial markets are critical to long-term economic growth and the CFTC and EU share a mutual interest in applying our regulatory and supervisory programs in such a manner as to avoid overlaps, gaps and conflicts.

With the pending passage of new amendments to the European Market Infrastructure Regulation (EMIR 2.2), the sentiments I expressed before are even more relevant today. EMIR 2.2 gives the European Securities Market Authority (ESMA) and European Central Bank (ECB) powerful new tools to regulate and supervise third-country CCPs. But with such new powers, also comes a responsibility to use those powers carefully and wisely.

"EMIR 2.2 now looks to revisit [2016 CFTC-EU Agreement] – hopefully to build upon the agreement in a positive way and not to tear it down."

- ERIC J. PAN

As noted by the G20 Leaders in 2009, central clearing is a critical measure to mitigate systemic risk in the global financial system. CCPs must be able to conduct their services across borders, allowing market participants around the world to manage their risk. A lack of coordination on supervision of CCPs will undermine this objective, increasing risk to the global financial system.

In 2016, the European Commission and CFTC concluded three years of negotiations to reach an agreement on the terms and conditions of (i) what EMIR requirements US CCPs would have to follow in order to provide clearing services to European market participants and (ii) what EMIR requirements would be included in the CFTC's substituted compliance regime for EU CCPs. Those terms and conditions set forth a deference-based regulatory and supervisory framework that governs how we regulate and oversee each other's CCPs. Moreover, this framework has helped our trans-Atlantic market operate smoothly by providing regulatory certainty to market participants. EMIR 2.2 now looks to revisit this agreement – hopefully to build upon the agreement in a positive way and not to tear it down.

The CFTC is fully supportive of the EU's efforts to strengthen its institutions and its financial markets. CFTC Chairman J. Christopher Giancarlo has expressed his great respect for, and desire to work constructively with, all EU authorities, especially ESMA. Chairman Giancarlo has spoken at Eurofi about the importance of regulatory and supervisory deference where we can rely on each other because we have strong regulators on both side of the Atlantic Ocean who are dedicated to cooperation and comity.

The CFTC has a long track record of working well with non-US regulators with respect to the supervision of cross-border CCPs. The fact that CCPs in the United States, Europe and other jurisdictions have thrived in serving U.S., European and other international market participants is evidence of this success. The CFTC hopes that we can continue to work with EU authorities to make sure this history of success continues well into the future. ●

Claudio Impenna

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The new EU regulation on CCPs: the costs and benefits of a complex route

After a difficult negotiation on the role and powers of different authorities, the supervisory framework of European CCPs ('EMIR 2.2') is being finalized. The first review exercise ('EMIR Refit') was merely for fine-tuning, aiming (primarily) to increase the efficiency of the OTC derivatives market reform; the UK referendum outcome then made the need to tighten supervision on third country (TC) CCPs an urgent issue.

The new framework has two basic features: i) to enhance the coordination and consistency of supervision over CCPs in Europe, strengthening the role played by ESMA and central banks of issue (CBI), and ii) to acknowledge national fiscal responsibilities.

ESMA's supervision of TC CCPs is greatly reinforced, following a proportional approach: a lighter supervision applies to CCPs that are not systemically relevant for the EU, whereas EMIR 2.2 applies to CCPs playing such role. Finally, a relocation requirement in the EU is imposed on 'super-systemic' CCPs, whose clearing activity may >>>

>>> significantly impact financial stability in the EU. Supervision will be exercised by ESMA's Supervisory Committee, mainly composed of national authorities. CBIs will play an important role for TC CCPs: they will be consulted by ESMA as regards clearing activities deemed relevant for the conduct of monetary policy, and will also be able to set additional requirements for them.

A 'more Europe' stance is being pursued in the supervision of EU CCPs as well. A clear allocation of responsibilities among national competent authorities (NCAs), colleges, ESMA and CBIs and a satisfactory balancing of their needs are under way. NCAs hold a primary role in the supervision of EU CCPs, for which Member States retain fiscal responsibility, and chair the colleges whose competences increase; ESMA fosters supervisory convergence in the EU through its Supervisory Committee, while CBIs bring their expertise both to the colleges and to the Committee.

"Overall, the new framework seems to add complexity to CCP supervision."

\- CLAUDIO IMPENNA

Overall, the new framework seems to add complexity to CCP supervision: decision-making will likely become more costly and time-consuming, since coordination is needed among multiple authorities; compliance burdens for CCPs will increase as well. It could be asked to what extent the old architecture needed changing, which after all had proved to be effective. Structurally adjusting the supervisory framework on TC CCPs after the UK referendum was certainly a requirement, as well as taking account of the increasing interconnectedness and integration in the European clearing market. Having said that, the objectives of consistency in supervisory practices and outcomes and of a correct allocation of responsibilities among authorities could likely have been pursued also through a more proportional approach to the treatment of EU CCPs. The highest prudential requirements (e.g. cover 2 for both credit and liquidity risks) are applied to all CCPs, irrespective of their size, business model, and assets cleared; more proportionality would likely be beneficial for the competitiveness of EU CCPs in the global financial system; after all, it is the model adopted for TC CCPs. Nevertheless, this is now a challenge ahead of us, pointing perhaps to a future 'EMIR 3'. ●

Laurence Caron-Habib

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Supervision of non-European CCPs – will EMIR 2.2 bring answers on all aspects?

The European Commission's decision in December 2018 to adopt temporary equivalence for UK CCPs in case of a no-deal scenario was definitely a strong positive development for all market participants. Indeed this big move by European authorities was inescapable in view of the potential systemic risk dimension of a statu quo approach. Otherwise the markets would have been confronted with a magnitude of systemic risk at least equal to the one experienced with the Lehman Brothers failure. First due to the time required to move such an amount of contracts from a UK CCP to a Continental European (in any case much longer than the remaining timeframe until end of March 2019). Secondly, as a result of most likely contagion effects on all financial participants, including those that would not been forced to migrate their contracts. The combination of these elements could have certainly resulted in a general crisis situation.

The question now is how long it will take to make the EMIR 2.2 text fully effective as the temporary equivalence granted by the European Commission is for one year only. The trilogue discussions between the European Commission, the European Parliament and the Council are on track and will probably end in a consensus before the European elections in May this year. However implementing measures will still have to be adopted before the new text can enter into force for true. That will probably take several months due to the associated consultation process and the topics to be addressed. A key area for review will be the criteria to be applied for the identification of the highly systemic non-European CCPs, i.e. those who represent a high systemic risk for the stability of the Euro in case of crisis situation. They will be used to identify the situations where relocation of €-denominated clearing would be imposed.

"Question is how long it will take to make EMIR 2.2 effective as temporary equivalence is for 1 year ?"

\- LAURENCE CARON-HABIB

Beyond the legislative framework, there is still a question mark on what will be the available offering in Continental Europe post-Brexit for segments which have to be relocated. There are some contracts for which the alternatives are quite limited. If a new CCP is to be built in a quite short timeframe, it is not to be excluded that such a challenge is not feasible and may require much more time to achieve a satisfactory end solution which meets at the same time the expectations of the industry and those of the public authorities.

In that context the possibility to extend the temporary equivalence of UK CCPs is to be considered and may prove to be the most appropriate solution, as long as final measures are adopted and financial players can adapt to the new landscape. In addition, whatever the final outcome, it is essential to ensure that potential resulting fragmentation of the liquidity would not cause unlevel playing field for European market participants. Otherwise it could result in their exit from this business where effective competition is probably one the most efficient safeguard for financial stability. Such developments could also have indirect negative impact on the financing of the economy in Europe, which is in total contradiction with the purpose of the Capital Market Union project. ●