Association for Financial Markets in Europe

Position paper

European Commission's proposal for a regulation amending EMIR (EU 648/2012) as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs and amending the regulation establishing ESMA

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The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the Commission's proposed regulation as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs (the "EC Proposal").

AFME[1] represents the major international banks operating in Europe and has therefore a keen interest in the regulation of Central Counterparties (CCPs) that provide clearing services in the EU. Particularly in the domain of OTC derivatives, robust and efficient clearing services enhance the safety of the risk reducing transactions undertaken by real economy corporates and investors.

Against this background, to ensure financial stability and preserve the efficiency of European and international capital markets:

1. We support the main elements of the EC Proposal to enhance the supervision of CCPs in the EU and in relevant third countries to foster financial stability and strong competition among CCPs within and beyond the boundaries of the EU. Given the derivatives market's global nature, this would involve strong cross-border supervisory cooperation. We note that the FSB produced a broad range of approaches to deference which may be helpful in this context[2].
2. We consider that regulatory requirements that lead to fragmented, inefficient and expensive markets for real economy corporates and investors should be avoided.
3. We call for maximum consistency between the Commission's proposed supervisory reforms and existing proposals on recovery and resolution of CCPs in the EU. Further, given the global character of derivatives clearing, AFME supports alignment with the global standards developed by FSB/CPMI-IOSCO on CCP resilience, recovery planning and resolvability.

[1] AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

[2] http://www.fsb.org/wp-content/uploads/r_140918.pdf

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AFME supports the European Commission's objectives of achieving enhanced supervision of CCPs, and of mitigating potential systemic risks in the context of highly integrated global and European financial markets.

We consider that, despite the proposed withdrawal of the UK from EU, the most desirable outcome is a situation in which EU and third country CCPs can continue to service integrated global markets, and in which risks associated with such an outcome are managed appropriately and proportionately.

1. **Broad support for the European Commission's proposals to enhance the supervision of CCPs in the EU and in relevant third countries including strong cross-border supervisory cooperation.**

   a. Strong cross-border supervisory cooperation

AFME believes that the concerns of EU legislators in relation to the regulation of systemically important CCPs ('Tier 2 CCPs'), and the possible risk that they may represent to the financial stability of the Union, are valid and can be met through the enhanced oversight arrangements included in the Commission's proposal.

The new supervisory powers envisaged by the EC Proposal will see ESMA become a co-supervisor of a Tier 2 CCP, a significant improvement to the present EMIR third country CCP regime which relies on supervisory cooperation arrangements between ESMA and the third country CCP's home supervisor. More specifically, to become recognised under EMIR, a Tier 2 CCP would need to formally agree to provide ESMA with all relevant information and to enable on-site inspections, as well as, to provide a legal opinion confirming that such commitments are valid in their home jurisdiction. Furthermore, the Central Banks of Issue will be given powers to impose additional requirements to carry out their monetary policy tasks on Tier 2 CCPs seeking recognition.

AFME supports the call for stronger and more effective cooperation between supervisors while noting that such joint supervision should be coordinated, consistent and non-duplicative. Enhanced oversight of Tier 2 CCPs should also be appropriately calibrated. It will be important to engage industry in the future outcome and we believe that policymakers should publish a consultation paper allowing for an in-depth discussion about the practicalities of the joint supervision of such CCPs.

   b. Supportive of proposed comparable compliance

AFME supports the approach in the EC Proposal of allowing comparable compliance by Tier 2 CCPs as third-country CCPs may already be subject to comparable requirements in their home country which are consistent with those in EMIR. Comparable compliance also encourages regulators to adhere closely to internationally agreed standards for CCP oversight.

   c. Under ongoing supervision of CCPs, any ex-post measures proposed in response to exceptional circumstances should be implemented with the approval of the relevant competent authorities of third countries

AFME supports the current measures in EMIR Art. 49 that CCPs, including those based in third countries, should regularly review the models and parameters adopted to calculate margin requirements, default fund contributions, and collateral requirements. They should also be subject to rigorous and frequent stress tests advising their relevant competent authorities and ESMA of the results. To maintain the stability of a CCP, the EC Proposal should clarify that a supervisor should not take any arbitrary, ad-hoc or subjective action in relation to margin requirements, default fund contributions or collateral requirements.

The abovementioned parameters and models should continue to be agreed ex-ante to provide clarity and predictability to their members who will need to make available sufficient margin. However, should it become necessary to impose ex-post measures, it is vital that the members and their clients are confident that these are proportionate and in line with prudent risk management at the CCP.

Furthermore, CCP models and parameters should be designed to avoid procyclical features and, once agreed and included in the CCP's rulebook, any ex-post measures proposed in response to exceptional circumstances should be implemented with the approval of the relevant competent authority in appropriate and timely coordination with ESMA and the relevant central bank of issue.

d. Enhance the methodology for assessing systemic risk of CCPs.

AFME acknowledges the concerns expressed by the European Commission and other EU institutions with respect to third country CCPs deemed of substantial systemic importance to the EU's financial stability, and is broadly supportive of the principle of joint supervision provided it is appropriately calibrated. We also recommend assessment of systemic risk at the individual CCP product level. A number of CCPs offer clearing of multiple products. Deeming a CCP to be of substantial systemic importance will impact all products it clears, some of which may not be material, or even relevant, to the EU.

Therefore, any requirement or decision imposed on a third country should apply to the specific currency, segment or product offering, rather than to the CCP itself.

2. Regulatory requirements that lead to fragmented, inefficient and expensive markets for real economy corporates and investors should be avoided.

a. Impacts to financial stability and risk arising from the loss of recognition

The draft proposal states that the European Commission could withdraw or deny recognition to third country CCPs of substantial systemic importance to the EU financial system.

AFME is concerned that such action could have unintended consequences to financial stability as well as adverse effects on operational and systemic risk in the EU, impacting not just banks but also imposing a cost impact to real economy investors:

- The withdrawal or denial of recognition would give rise to a bifurcation of market liquidity, creating the risk of an offshore (third country) market that would be more liquid and efficient than the nascent onshore EU market. This could create an unlevel playing field. The underlying costs of clearing for an EU client (subject to EMIR) could be more expensive because it would be required to clear OTC derivatives contracts subject to the EMIR clearing obligation via a potentially less liquid (i.e. with less netting opportunities) EU CCP, whilst non-EU clients not mandated to clear under EMIR would have access to a more potentially liquid market. EU27 (excluding the UK on the basis of its scheduled withdrawal from the EU) banks servicing EU and non-EU clients, and any other bank servicing EU clients, will be subject to the EMIR framework. While clearing such business on EU CCPs, they may need to pass on additional charges to their clients arising from the underlying cost differential between such onshore and offshore markets. Whilst clearing on more liquid third country CCPs, non-EU banks servicing non-EU clients could face lower underlying costs to perform similar clearing activities.

- We also anticipate that the creation of these two markets for the same asset (one for EU participants and another for non-EU participants) would lead to a loss of current netting and compression arrangements, distorting competition whilst increasing systemic risk both in the EU and across the global markets. EU counterparties subject to EU regulations will be unable to use non-qualifying CCPs that serve these markets without providing for significantly higher capital requirements and thus may be confined to a narrower, onshore market where trading is less liquid, and the basis spread and margin costs are higher.

- The requirement for multiple CCP memberships in EU and non-EU countries together with a reduction in netting and compression could lead to an increase in EU dealers' margin and default fund requirements.

Associated costs may be passed on to the real economy (e.g. EU corporates and EU investors).

- For entities based in the EU27, a limited availability of alternative clearing venues and the concentration of risk across a smaller pool of CCP members.

b. Withdrawal of recognition - measure of last resort given risk concerns and enhanced oversight of third country CCPs

AFME strongly believes that a withdrawal of recognition should be avoided given the extensive proposals for enhanced supervision of third country CCPs and the potential for disruption in the markets.

Our membership believes that market fragmentation should be minimised and therefore encourages the Commission to take into full account all the consequences of the imposition of the withdrawal (or denial) of recognition of a third country CCP on the sole ground of its systemic importance, the serious risks of which we have highlighted above.

AFME considers any withdrawal (or denial) of recognition from a third country CCP deemed to be of "such substantial systemic importance" to the financial stability of the Union or of one of its Member States, should only be a "last resort" measure (as mentioned on page 70 of the Commission's Impact Assessment and in President Dombrovskis's statement on 13 June 2017). Such a withdrawal (or denial) of recognition should be applied only when the twin conditions are met of (i) a CCP of substantial systemic importance, and (ii) a determination by the European authorities that the risks associated with that CCP are not being adequately mitigated by the measures set out in the proposed paragraph 2(b) of EMIR Article 25.

It is crucial that the qualifying term "substantial systemic importance" is defined further and we would welcome clarification in the EC Proposal of the criteria that would prevent a third country CCP from being granted recognition, particularly:

i. the circumstances and conditions under which the EU authorities could withdraw or deny recognition, and

ii. the practicalities, including an adequate transition period and other actions intended to mitigate the disruption to financial markets that such a step would entail.

3. We call for maximum consistency between the EU and Global standards for CCP Recovery & Resolution

AFME supports the global standards developed under the coordination of the Financial Stability Board (FSB), the Committee on Payments and Market Infrastructures (CPMI) and International Organization of Securities Commissions (IOSCO) to promote CCP resilience, recovery planning and resolvability to ensure that CCPs are held to consistent minimum standards regardless of their jurisdiction.

Guidance is provided to establish Crisis Management Groups in the 2017 FSB Guidance on CCP Recovery and Resolution planning which would coordinate the resolution planning and resolvability assessments. We would welcome continued efforts to align the European Commission's proposals on CCP supervision and recovery and resolution to the approaches in the FSB and CPMI-IOSCO documents to ensure that these crisis-management dynamics are globally consistent. AFME supports the continued actions of EU authorities to work collaboratively with their international counterparts and to implement these globally agreed standards.

These above measures will contribute to a stronger and more effective cooperation between regulators and market infrastructure. It will be important that the precise recognition and supervisory requirements to be placed on systemically important third country CCPs, resulting from the EC proposed regulation on CCP Authorisation and Recognition, are detailed and published well in advance of the application of the new framework.

Conclusion

AFME recognises that European markets will play a major role within an integrated global financial system. As such, we believe that EU regulation that minimises disruptive effects on users of financial services, such as a fragmentation of clearing markets or an unlevel playing field across the industry, and ensures the robustness of the Capital Markets Union is the most desirable outcome. We note that other jurisdictions such as the US, Australia and Canada have already adopted a similar integrated approach.

EMIR laid the groundwork for CCP supervision and cross-border cooperation, and we welcome the Commission's proposal to further improve this framework for effective communication between the CCPs, ESMA, central banks and the ESRB. In conjunction with the new Commission proposal which foresees joint supervision between ESMA and home regulators and the globally agreed international standards for CCPs, we believe European and third country regulators will now have an appropriate forum to discuss and address their respective concerns and an appropriate supervisory toolkit.

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