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"Supervision of EU and third country CCPs"

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Since last Eurofi meeting in Sofia in April this year, when we had a good panel discussion on the same topic, in the European Parliament we have agreed on common position on EMIR 2.0 It was voted on 16 May in the ECON committee, with a strong broad majority that authorized me as rapporteur to start negotiations with the Council.
All the compromises I proposed have been adopted, so the proposals I presented to you in April are basically maintained. As our position is clear, we are waiting for the Council to finalize its own general approach in order to be able to start the trilogues.

Let me, therefore, say one word on the timing of that file. Indeed, this is a file which has to be completed soon because of Brexit. We need to have an adequate regime for the recognition of third country CCPs by the Brexit date. But I am happy to hear Steven reminding us here that already in 2015 ESMA presented its opinion pointing to weaknesses of market infrastructure supervision and the need to improve it.

However, of course, if we manage, in the Brexit negotiations, to have an agreement on withdrawal and as a result also a transition period, then there will be less time pressure. We would then be able to use the transition period to finalise the negotiations on the EMIR text and to negotiate the equivalence of UK CCPs. And to make recognition decisions if needed. I am underlining this link between withdrawal and transition because sometimes we hear politicians ignoring this conditionality. No deal on the withdrawal is not for negotiations either. It would be a situation when negotiations fail. So also those who say we can negotiate a no deal scenario are wrong. We will have more certainty or, I should rather say, less uncertainty in November, when most likely extraordinary Summit can take place.

This means we will not know whether there will be a transition period until very late in the process, and this is something we need to take into account when reflecting on

the timing of the EMIR file. I am saying this looking at the Austrian Presidency Representative in our panel, Paul Pitnik. A lot now depends on the Council.

Let me also go back for a while to what I already mentioned which is that finalizing the EMIR file is not only a pressing matter from a Brexit perspective but is also urgent for the sake of the smooth functioning of markets. There are reforms introduced by the Commission proposal and by the European Parliament report that are improving the way CCPs will be supervised. For instance, among other new provisions, the new regulation will introduce some degree of increased supervisory convergence within the Union and will strengthen the framework for the supervision of third country CCPs.
As I said before, these are reforms necessary even without Brexit and there is no reason at all to delay them. Delaying will only create more uncertainty over the future regime among market participants. So, I am counting on colleagues in the Council to hold fruitful talks and progress swiftly so that we can reach an agreement between the three institutions soon enough.

And let me say another word on Brexit. We are strongly focusing today, when we discuss the impact of Brexit, on financial stability. However, we also have to assess the longer-term effects of Brexit coming from less market access, less integration and more fragmentation. And we all remember how much, on both sides of Atlantic, we have invested after 2008 crisis into reducing fragmentation and letting the financial markets work globally.

So, not much has changed since April, and I would like to say that I still insist on creating, within the structure of ESMA, a framework that could be used for the supervision of both EU and third country CCPs. We want to keep those two dimensions as close as possible. Proceeding differently might entail duplication of work, inefficiency in the final set-up and a potential loss of credibility for ESMA during all the period when it would be supervising third country CCPs but not EU ones. Moving in this direction is important and I hope the Council will move toward a common framework for the supervision of all CCPs in the final solution that it will put on the table for negotiations.

I would now want to touch upon few points which have been subject to a long reflection and discussions with all stakeholders.
Maybe first some words on what concerns both EU and third country CCPs which is the role of the Central Bank of Issue.

I am mindful of the concerns that the intervention of central bank might raise in case of third country jurisdictions. I have heard, in particular, concerns that the possibility for the central bank to intervene with too much discretion might be disruptive for third country supervisors. This could be because the central bank could take decisions that might be possibly going against the wishes or strategies of the third country supervisors. This is precisely why I did not leave a carte blanche to the CBI. This is why I have tried to create more legal certainty compared with the Commission proposal.

There can be, however, a question of how much flexibility should be left in the system. By definition, the exceptional circumstances under which some intervention from a central bank will be necessary cannot be foreseen. We do not want to be facing a case where action from the central bank would be needed and could not be taken. So, we had a delicate balancing act to perform in order to ensure both legal certainty and flexibility.

I think the European Parliament report has gone a long way towards achieving this balance. We could have now a system which would be as little discretionary as feasible while leaving freedom to act for the central bank. The issues that the central bank can address would be limited, even in exceptional circumstances, to the five areas on which it is agreed that the central bank should be involved (liquidity, margins, settlement, collateral, interoperability), so there will be predictability. Also, any extension of decisions taken in exceptional circumstances would require approval from the co-legislators, so there would be a right of political scrutiny over them.

Then, regarding third country CCPs, besides the involvement of the central bank, I would like to mention four issues: the assessment of the systemic significance of a

CCP, the extent to which we defer to third country authorities, the way of organising supervisory cooperation and the denial of recognition procedure.

The first issue is this of the exact criteria to be used by ESMA for this assessment. They will be determined by the Commission through a delegated act. The European Parliament has already looked at it and intended to make sure that some activities that are not systemically significant for the Union would not be unduly captured in the assessment. So, in the recitals that will guide the interpretation of the text and the drafting of the delegated act, the European Parliament introduced elements to be looked at by the Commission when drafting the delegated act on the detailed conditions for designating a CCP as systemically significant. Those recitals will ensure that clearing agricultural commodities and clearing third country equities on third country markets will not be considered activities that are systemically significant for the Union.

There is also the related issue of what activities we look at in order to assess significance: should we look only at the activity in the Union? This might make sense, but the overall size and complexity of a third country CCP, including its activities outside the Union, might also impact the probability of a CCP to fail or otherwise determine its significance for the Union. We had very diverging views on that issue in Parliament when discussing the text, and we found a compromise wording which is: “ESMA should take into consideration the business carried out by the CCP in the Union as well as other business of the CCP outside the Union, to the extent that such business outside the Union is likely to affect the overall complexity of the CCP. “ I would consider this a balanced approach.

Then, on deference, I would like to recall that the approach of the Union as regards third country equivalence has always been based on deference and that deference to third country jurisdictions is the basic philosophy of EU third country regimes. The policy of the Union has been to grant recognition to third country entities that come from jurisdictions assessed as equivalent, comply with their own domestic requirements and are duly supervised in their own third country. Provided those conditions are met, the standard clauses regulating the recognition of third country entities in EU legislation typically do not lay down many additional requirements

apart from the requirement for respective supervisors to draw up a cooperation agreement. You can see this philosophy in article 25 of the current EMIR, or in article 25 of the Central Securities Depositories Regulation dealing with equivalence.

Deference is an approach which is not possible to fully maintain when we deal with entities that are of very high systemic significance for the EU market. However, we have tried to preserve it through the possibility for a CCP to ask for its comparable compliance and through the tiering of CCPs (since full deference will remain, under our approach, the norm for all Tier 1 CCPs).

Then, we all know - still it is worth recalling it - that supervisory cooperation and good relationship between EU and third country supervisors will be crucial to enable the right decisions to be made in normal circumstances but also in emergency situations. This is why the European Parliament report mandates, in particular, to include provisions on information exchange and cooperation arrangements in emergency situations in the memoranda of understanding between EU supervisors and the supervisors of all third country CCPs. I expect that will mean that the memoranda of understanding will include details on the division of labour between EU and third country regulators in emergency situations and therefore create the conditions for smooth cooperation in difficult times.

I would also like to remind you that the amendment to EMIR is not the only piece of legislation that will deal with the cooperation between EU and third country supervisors in emergency situations and in crisis times.

I have also been made aware that memoranda of understanding not being respected in practice might be more problematic than incomplete memoranda of understanding. That is why the proposal of the European Parliament includes two elements giving a more binding nature to memoranda of understanding. First, the right for ESMA to withdraw the recognition of a CCP if it finds that, due to unsatisfactory information sharing with the third country supervisor, it cannot properly exercise its powers over the CCP concerned. And second, the requirement for ESMA to inform the Commission if a third country authority fails to comply with the

provisions of the memorandum of understanding, after which the Commission might decide to review the implementing act granting equivalence to the third country.

Those proposals go further than the current EMIR equivalence requirements. Then, it will also be up to EU and third country supervisors to include more elements in the agreements they conclude between themselves and to create, on a day-to-day basis, a good working relationship. In the area of supervisory cooperation, not everything can be enshrined in legislation.

And it will also be important to have good international standards and to keep adhering to them, so that all supervisors can work within a framework. Fortunately, in the area of CCPs, the PFMIs (Principles for Financial Market Infrastructures) give us sufficiently detailed standards.

As regards denial of recognition, as you know, our work in the European Parliament has been about creating more legal certainty around denial of recognition and making the process more fact-based and evidence-based, more proportionate and less discretionary.

I would consider the criteria we found in the European Parliament report to be well-targeted. After discussions and consultations, it had become clear that the following elements mattered in order to determine a potential decision to deny recognition:

- the type of transactions cleared by the CCP. We all know that repos are liquidity intensive and used for monetary policy transmission. The case for having them cleared in the monetary area where they are denominated is, therefore, stronger than for other transactions. This is why we already see the clearing of repos relocated by LCH in France, in the euro area. What really matters is the risk associated with the transaction and the risk that one day the central bank would have to intervene.
- the substitutability of the services provided by the CCP. It is obvious that it makes less sense to deny recognition to a CCP if there is no other CCP providing the same services to EU members and clients. A small caveat to make is that it could be worth taking, in case it is relevant, a dynamic approach and to look at viable substitutes that could potentially emerge over time, and not only at the market situation at a

point in time. This is why the European Parliament's report refers to the presence of "viable potential substitutes"
- the situation of outstanding contracts. They will have to be transferred to another CCP, which takes a lot of time for the industry to arrange, and this is where the real issue with denial of recognition and its associated costs lies.
You know also that in the spirit of making the decision of denying recognition more fact-based and more proportionate, the European Parliament proposes the option for the Commission to deny recognition only to one or some clearing services and not to the whole CCP. This way, it will be possible to have a proportionate approach and to address the problem where it really lies, in case it would be feasible to separate clearing services.

Also, of course, since no denial of recognition has ever taken place, we do not know how disruptive a decision to forcibly terminate membership in a CCP might be for EU clients and members.

This is why the European Parliament report proposes that the Commission, when deciding to deny recognition, be able to set an adaptation period. It would have to look at whether or not it needs to grandfather existing contracts held at the CCP. This is also why we are fortunate that nothing in EMIR would prevent third country CCPs which are not yet or no longer recognised from keeping accepting EU members and clients. This is something for supervisors to look at in case of no deal on Brexit. This leads me to say that the probability of no deal is currently high, but whether risks from no deal will materialise will depend on the preparedness of the industry and on supervisors. We are in that regard still waiting for a no-deal strategy for CCPs.

But the truth is that we know that what is possibly costly is the transfer of already existing contracts held at the CCP. However, we are hearing a lot, in the context of Brexit, about contract continuity and the issue seems apparently in the process of being resolved by the industry itself quite well, with only possibly the novation of contracts concluded before Brexit being a potential issue. I know that the Commission is looking into this issue.

In any case, I think it is better to let relocation happen through market mechanisms, if it is found to be necessary. Then, mandating relocation through denial of recognition should remain in legislation as a last resort tool that should not be used lightly but should fully remain an option.

On the supervision of EU CCPs, I would just want to recall very briefly the approach taken in the Parliament and to mention two issues. First, division of tasks between ESMA and the national competent authorities and second, the internal organisation of ESMA.

The allocation of tasks between ESMA and NCAs proposed in the current European Parliament report is purposely balanced and open since what we wanted was to set a structure on which we would build in trilogues.

Under the approach of the European Parliament's report, competent authorities which would have to obtain the binding consent of ESMA for some important decisions (where the experience has shown that supervisory practices diverged markedly, for example approval of margin models or extension of authorisation), consult ESMA for other decisions (typically decisions for which there already is a mandatory consultation of the college) and adopt other decisions on their own without consulting ESMA or having its consent.

This would allow to involve ESMA where it is most needed and therefore to efficiently target its input and resources.

Of course, within this structure, there is a wide range of possibilities regarding the final allocation of the tasks (that is, what exact decision falls in what category) and I look forward to discuss this allocation with the Council.

When reflecting on the exact allocation of tasks, we will have to be careful to study what types of decisions are related to each other so that we do not break the logical unity between some groups of decisions (for instance, all decisions related to corporate governance should be subject to the same regime, logically). We also have to avoid, as much as possible, creating complexity.

Still as regards the division of tasks, there was a question asked in preparation to this panel, and a lot of talks in the Council, about strengthening supervisory colleges. I believe this is a good way to create more supervisory convergence and to involve Member States in the process so that decisions are not imposed but come from awareness and coordination from below as well. This is why the European Parliament makes suggestions to strengthen colleges: lower the threshold for requesting binding mediation after college members have objected a decision on authorisation, allowing college members to raise issues concerning the resilience of a CCP and, on this basis the college to make recommendations to improve the resilience of a CCP. We also intend to strengthen ESMA within the colleges by allowing ESMA to assess the risk management practices of CCPs and by accepting that ESMA will chair and manage the colleges, as proposed by the Commission.

These are ideas aiming at improving supervisory cooperation between national competent authorities.

But what if there are divergences at another level: if different colleges take different approaches to similar issues? We are also in the context of Brexit and we are starting to see, and will see probably for a few years to come, increasing risks of fragmentation and supervisory race to the bottom in order to attract activity to the continent.

So, for those reasons, while I think that EMIR colleges are definitely to be strengthened but that we also need some kind of central body or platform that would ensure coordination and supervisory convergence above the level of colleges.

I hear there are now talks in the Council about a solution that would strengthen supervisory cooperation between colleges: creating a platform where issues arising in colleges could be raised and discussed and where supervisory convergence could be improved. This platform could issues recommendations, which could be non-binding, or subject to a comply or explain procedure, or depending on the final system agreed on.

An internal committee of ESMA could constitute this platform and this setup would be a basis for finding the right balance for involvement of ESMA in supervisory tasks. The European Parliament's report already has a mandatory review of the division of labour between ESMA and the NCAs after three years. So yes, the creation of a platform under the umbrella of ESMA, where CCP supervision would be discussed, accompanied with a strong review clause, is something worth looking at.

And my last point will relate to the internal organisation of ESMA.
The creation of a body dedicated to CCP supervision within ESMA, whatever its legal status, is necessary so that we recognise the specificity of CCP supervision and can gather proper experts on this issue within ESMA . In the European Parliament, we decided to create an internal committee legally based on the existing ESMA regulation, and keeping it as a structure that would be used both for the supervision of EU and third country CCPs. If we have people knowledgeable on CCPs around the table, that is, central banks and national competent authorities, then the exact composition of the committee (exact size number of representatives, presence of the Commission or not) does not matter much. On this we can find agreement.