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"Building European financial power without negative implications for the market and for the UK"

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It is true that unlike the outbreak of the COVID-19 pandemic, the withdrawal of the UK from the EU did not fall on our heads without warning. For years and across the economy, market participants have been preparing for the moment of withdrawal and the end of the transition period.

I have always had the impression that in the financial sector the hope or expectation that a large fragment of the status quo would remain longer than among other market participants. Yet, we are, already today, in a different place with the debate compared to last year. The status quo is now largely gone and there is a substantial dose of uncertainty for the future.

Financial sector is only marginally present in the Treaty on Trade and Cooperation. Already for a while, we have been on a rather strongly bumpy road towards the implementation of both the TCA and the Withdrawal Agreement. I am mentioning this factor, as, whilst it may seem theoretically unrelated, it is difficult to look at financial services in separation from the bigger framework. In particular, the difficulties related to the implementation of the crucial elements of the WA and the Protocol on Ireland and Northern Ireland are not only teething problems, but are fundamental issues that do not inspire trust. It is, indeed, legitimate to ask whether we can count on a cooperation based on good faith or more broadly on a cooperative approach in the context of financial sector, when experience in other areas is truly a bad one.

The new status quo is that the UK is no longer a financial center of the EU. It also seems justified that the EU aims at strengthening its financial powers and wants to see its financial markets grow.

The EU has realized that in order to strengthen its competitive advantage in the financial sector it has to complete unfinished reforms, in particular the Banking Union, the Capital Markets Union and its Crisis management capacities. These broader frameworks are of crucial importance in order to facilitate the work of the

supervisors and in order to reduce risks coming with national options and discretions.

One important issue that must be taken into account is the need to build our rulebook and EU structures that are fit for times when things will not go well, when there will be disruptions and crisis. Another challenge is that we cannot build our capacities on the assumption that there will be no divergence between the EU and UK rules and systems. The truth is that rules will change on both sides. However, on the other hand, it seems hard to imagine how a third country CCP that is classified as Tier 2 under the EMIR 2.0 framework - meaning a CCP that is systemically important for the EU, directly supervised by the ESMA CCP Supervisory Committee, depositing euro collateral with the European Central Bank (ECB), and using concentration account giving ECB full visibility of all flows in euro, could have an interest diverging from the EU requirements.

Since the beginning of our reflection on the EU's preparedness for the UK withdrawal, the clearing of euro denominated derivatives was identified as a major source of risk. In this context, the idea of having excessive exposures to a third jurisdiction - in this case UK, not only for clearing but also for trading, has become an issue. The question is whether these excessive exposures can be easily defined and measured. The answer is probably not. Do we have clarity on how the excessive exposures can be reduced? Not yet.

In a special task force, the Commission is talking with the industry, supervisors, stakeholders, the European Supervisory Authorities (ESAs), the European Central Bank (ECB), EU and third-country jurisdictions clearing members and asset managers looking exactly at what can be considered as excessive exposure. It seems that ultimately clients make their choice where to clear based on a number of important factors including price, liquidity, operational costs, margin efficiency. Considering the current situation, it does not come as surprise that clients demonstrate certain reluctance to move clearing to the continent. Certainly, I can imagine, that closing positions in the UK and reopening a legacy position in the EU might be challenging. Moving thousands of open contracts would be difficult - if at all possible, without creating market instabilities. However, the issue of new transactions might be an open one.

Subsequently, if not voluntary, which might take years to incentivize, one may be tempted to limit exposures by rules, assuming they will be enforceable without undermining confidence. But then, industry warns that this may harm the growth of financial market infrastructures and bring negative consequences for EU clearing members and market participants of all sorts, financial, commercial, operational, risk related.

Maybe building up clearing liquidity can be market driven and voluntary but it can also be accompanied by incentives offered by a rulebook that is lowering barriers to entry across market. It does not have to be a hard choice between political will and market practice.

It is, nevertheless, hard to imagine a situation when banks could be forced to move without their clients as a result of a location policy aiming at reducing excessive exposures. European banks should not be deprived of the ability to offer clients a choice. It is hard to question the need to ensure that EU firms can freely choose where they clear based on liquidity and high-risk standards. If the EU wants to build its financial power, EU firms need to access global markets and manage their risks efficiently. But is London the only gateway to other currencies when EU banks have global presence?

There is also the big issue of breaking the liquidity, when fragmented market is most likely more costly. Probably, we should listen to European Securities Markets Authority (ESMA) whether it is feasible to handle the risks and costs of fragmentation of liquidity.

Another question that in my view must be taken seriously in our reflection on how to move forward is the credibility of the system. EU has no other option than investing in a credible system. Immediately the question appears whether we can have a credible, stable, efficient system having most market infrastructures in other jurisdictions.

In the European Parliament this issue has also been raised in our debates on the international role of euro. There, it has been legitimate to ask whether we can have a globally relevant currency without a credible financial system. This is actually a question to market participant - what is for you a credible system? Can you imagine a credible system with a location policy?

I can imagine that it is also legitimate to ask what would any loss of equivalence or recognition mean for markets. On the other hand, one can also ask whether a free movement of liquidity between the EU and the UK can become a challenge for the stability of the Eurozone. An economy of the size of EU has to build its own financial power. Can a third jurisdiction can be trusted to cater for the stability of the Eurozone?

Exactly because of this concern, still before Brexit, the idea that repos should be transferred to Paris appeared. LCH SA repoclear cleared recently debt issued under the SURE program, which is now commonly used as collateral. There are also concentration accounts in the ECB securing visibility of all flows in euro. Apparently,

euro government debt market involves managing important euro liquidity and settlement risk and all government debt repos are cleared out from Paris. I believe we have created a system with strong safeguards against financial stability risks and concerns.

I have serious doubts whether we might find all needed solutions without an open and constructive dialogue between the EU and the UK authorities. The regulatory cooperation and deference will be important. One can see as rational to have a constructive dialogue with UK to find in a cooperative way on how it could facilitate building European financial power without negative implications for the market and for the UK.

I think US Secretary Blinken said that stronger partners make for stronger alliances. Maybe this is the way to go in the future partnership between the UK and EU. Nuclear options should be avoided. I am thinking here about moving all global euro clearing by rules to the EU or allowing equivalence to expire. UK needs a deal with the EU on a permanent equivalence.