

## EPFSF Briefing Paper on

# “EMIR 3.0 - How to strike the right balance between financial stability, attractiveness and competitiveness of EU financial markets?”

### Introduction

The EPFSF event is looking at the European Commission’s (“EC”) proposal to address the financial stability risks perceived from the continued over reliance on systemic UK Central Counterparties (CCPs) and strengthen the EU clearing ecosystem. Speakers will not only discuss whether the proposal will achieve these objectives but also cover the potential unintended consequences that certain measures might have on EU market participants’ competitiveness and the EU economy more broadly.

### The proposal

The EC longstanding position, in line with the European Central Bank (ECB) and European Supervisory Markets Authority (ESMA) is that the risks to the EU financial stability arising from the heavy concentration of clearing in UK CCPs must be addressed. The EC therefore proposed in its December 2022 EMIR review to focus on measures to (i) encourage central clearing in the EU and safeguard financial stability, (ii) improve the attractiveness of clearing in the EU and (iii) enhance supervisory arrangements in the EU to address financial stability risks. The following sections discuss in detail the EC’s key proposals.

## I. Measures to encourage central clearing in the EU to safeguard financial stability

### Active Account Requirement

The EC introduces a new requirement (Article 7a) mandating financial counterparties and non-financial counterparties subject to the clearing obligation to hold active accounts at CCPs established in the EU, and to clear a proportion of the services identified as of substantial systemic importance at EU CCPs. Categories of derivative contracts subject to the clearing obligation and in-scope of Article 7a are (i) Interest Rate Swaps (IRS) in EUR and Polish Zloty (PLN), (ii) Credit Default Swaps (CDS) denominated in Euro and (iii) Short-Term Interest Rate Derivatives (STIR) denominated in Euro.

Furthermore, the proposal mandates the European Supervisory Authorities (ESAs) as well as the European Systemic Risk Board (ESRB), after consulting the ECB, to develop draft Regulatory Technical Standards (RTS) specifying the amount of clearing that must take place on EU CCPs. The calibration should not go beyond what is necessary and proportionate to reduce clearing in the identified clearing services at the most systemic CCPs (so called Tier 2). When determining those clearing activity thresholds, ESMA will have to consider the costs, risks, and the burden that such calibration entails for financial and non-financial counterparties, the impact on their competitiveness, and the risk that those costs are passed on to non-financial firms.

Finally, the EC proposes targeted amendments to CRD and mandates the EBA to develop processes to identify, monitor, and report the risks that EU firms are exposed to including from exposures to Tier 2 CCPs.

## Other provisions aiming at improving the competitiveness of EU firms and incentivizing clearing in the EU

Proposals to preserve the competitiveness of EU firms include, notably:

- The exemption from clearing and margining requirements for extra-EU cross-border intragroup transactions would no longer be subject to an equivalence decision. However, a list of jurisdictions for which an exemption cannot be granted will be established (AML high risk countries and non-cooperative jurisdictions for tax purposes).
- EU firms subject to the clearing obligation would benefit from an exemption when entering into a transaction with a pension scheme arrangement (PSA) established in a third country, which is exempted from the clearing obligation under its national law. As an example, the HMT has granted a 2-year extension of the clearing exemption for UK PSAs (until 18 June 2025) and EU firms would also benefit from this exemption.

The EC also proposes targeted amendments to both UCITS and MMF Regulations to increase clearing activity in the EU. Currently, EU Funds (UCITS, MMFs) apply counterparty ratios to ensure they diversify their risks and counterparty exposures. Counterparty ratios also apply to exposures with CCPs which limit the funds' ability to clear with EU CCPs. Proposed amendments remove counterparty risk limits for all derivative transactions that are centrally cleared by a CCP that is authorised or recognised under EMIR thus making central clearing with EU CCPs more attractive for those participants.

Lastly, the communication that accompanies the legislative proposal included an encouragement for public entities to clear voluntarily through an EU CCP to make central clearing in the EU more attractive, but the proposal itself does not allude to that topic.

### II. Measures improving the attractiveness of EU CCPs

The EC proposes to simplify the EU CCPs procedures for launching products and changing models and parameters and introducing a streamlined process for certain changes. In addition, to reduce the amount of time required for the approval process to be completed, the EC introduces the use of centralized databases to promote cooperation between authorities.

### III. Enhanced supervisory arrangements

The EC proposes to enhance cross-border supervisory cooperation within the EU through a more structured interaction between ESMA, National Competent Authorities (NCAs) and CCP Colleges and through the set-up of a Joint Supervisory Team (JST). The tasks of JST include: (i) to provide input to the CCP's competent authority within the context of the non-objection procedure for extending a CCP's existing authorisation, (ii) to assist in establishing the frequency and depth of a CCP's review and evaluation and (iii) to participate to on-site inspections.

Furthermore, to enhance cross-border supervision and financial stability in the EU, the EC proposes an extension of the scope of existing MoUs with the relevant third country authorities of Tier 1 and Tier 2 CCPs. This will enable ESMA to be informed and sighted on a CCP's resolution plan and kept abreast of key developments or actions to be taken by the home authority during an emergency.

### Conclusion and issues for discussion

The EC acknowledges that central clearing is a global business and EU market participants are active internationally. Derivatives market participants in the EU access global liquidity pools to manage their risks. On one hand, the EC proposal intends to address perceived risks arising from a large portion of the IRS, CDS and STIR markets denominated in euro being cleared outside the EU and to improve the attractiveness and competitiveness of the EU clearing landscape. In line with the EC's open strategic autonomy, reducing dependencies on third country services is considered essential to increase the financial stability and ensure the EU remains resilient in the event of a crisis. On the other hand, many EU market participants have raised concerns in relation to the increased financial risks and costs that some of these proposals entail. They argue that access to diversified market infrastructures serving global markets provide market efficiencies that benefit not only EU clearing members and their clients (including end users) but the entire EU economy. They consider that limiting access to non-EU infrastructures will come at a cost and risks in the form of additional margins and higher prices for the EUR derivative contracts which will be negotiated in a less liquid market. They hence call for a cautious and gradual approach.

### Questions for discussion

1. Will the European Commission's proposal succeed in encouraging clearing in the EU and improving the attractiveness of EU CCPs?
2. Are there any other aspects which could be envisaged to achieve the EC's objective?
3. Does the current level of clearing outside the EU pose a risk to financial stability and will mandating EU active account help reducing that risk?
4. What are the limitations of the active account concept, what impact for clearing with non-EU clients?
5. What are the implications for the competitiveness of EU market participants?