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The European Commission's consultation on enhancing EU CCPs (EMIR Review)

Overview of the EU's proposals to incentivise more clearing activity to take place in the EU

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European Commission consultation on enhancing EU CCPs

Overview

The European Commission recently launched a targeted public consultation on ways to expand central clearing activities in the EU, improve the attractiveness of EU CCPs, reduce overreliance on Tier 2 CCPs, and strengthen EU supervision of CCPs.

The consultation considers a wide variety of measures, which are outlined on the following slides.

The proposed measures are as follows:

1) **Broadening the scope of clearing participants and products cleared**: the consultation suggests that one way to enhance the attractiveness of EU CCPs could be to widen the scope of clearing participants as well as the products offered for clearing or required to be cleared. The consultation considers a range of options, including:
   - Removing the temporary exemption Pension Scheme Arrangements ('PSAs') have from the clearing obligation.
   - More clearing by private entities which do not currently access CCPs directly.
   - Encouraging public entities, such as national banks or debt management offices, to participate in EU CCPs to increase their liquidity.
   - Extending the clearing obligation to a wider range of financial products (e.g. equity derivatives, repos, other interest rate derivatives, other credit derivatives, foreign exchange derivatives).

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2. **Higher capital requirements in CRR for exposures to systemically important third-country CCPs:** EMIR 2.2 introduced a distinction between third-country CCPs that are Tier 1 (not systemically important) and those that are Tier 2 (systemically important). The consultation proposes a number of ways higher risk weights could be applied to firms with exposures to Tier 2 CCPs, including:

- for the portion of the exposure which is above a certain threshold.
- for the overall exposure to a particular Tier 2 CCP.
- if there is evidence that no meaningful efforts are made to reduce the exposure to Tier 2 CCPs.

3. **Macroprudential tools:** the consultation posits introducing a macroprudential buffer to reduce reliance or over exposure to Tier 2 CCPs.

4. **Exposure reduction targets:** firms could be given specific targets for reducing their exposure to Tier 2 CCPs, based on the sum of their initial margins and/or default fund contributions. Respondents are asked to suggest what would be a reasonable target for an overall reduction in euro-denominated exposures of EU participants to Tier 2 third-country CCPs. Respondents are also asked over what timeframe this could be achieved.

5. **Measures to facilitate the transfer of contracts from outside the EU:** transactions entered into with UK counterparties before the entry into force of EMIR (legacy trades), are currently exempt from the clearing obligation. Any amendment to those transactions would trigger either the clearing obligation or margin requirements, depending on whether they fall under the clearing obligation or not. The consultation suggests a permanent waiver could be given to these contracts to allow them to be repatriated to the EU without triggering any EMIR requirements.

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6. **Obligation to clear in EU:** at present market participants can clear trades through authorised EU CCPs or recognised third-country CCPs (either Tier 1 or Tier 2). The consultation suggests that EMIR could be amended so that in future only clearing on EU CCPs or Tier 1 third-country CCPs would be allowed. This would effectively prohibit firms from clearing on Tier 2 third-country CCPs and is the strongest measure put forward in the consultation.

7. **Active accounts:** in order to increase usage of EU CCPs, market participants could be required to maintain an active account with an EU CCP for products that are available inside and outside the EU.

8. **Hedge accounting:** the consultation notes that the different accounting treatment of rebooking operations is an obstacle to rebooking market transactions between the UK and EU. The consultation asks whether there should be a harmonisation of the hedge accounting rules across Member States in order to reduce the exposure to Tier 2 third-country CCPs.

9. **Fair, reasonable, non-discriminatory and transparent (FRANDT) commercial terms for clearing services:** the consultation asks whether the FRANDT terms on which clearing services have to be provided should be amended, so that clients are consistently offered the option to clear on at least one EU CCP or are incentivised to do so.

10. **Measures to expand the offering by EU CCPs:** The consultation notes that market participants have said that the time needed for an EU CCP to expand its product offering or make changes to its risk models, e.g. to accommodate new products or currencies, is too long and hampers its ability to compete internationally. The consultation asks what impedes EU CCPs from expanding their services and what could be done to address this.

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11. **Payment/settlement arrangements for central clearing:** the consultation notes that some CCPs' margin calls can only be processed at a late hour, sometimes necessitating payments in USD, as Euro payments are not available at these times. The consultation says this puts EU banks at a disadvantage, since it makes them dependent on USD liquidity, even for satisfying margin calls by European CCPs. Consequently, the consultation asks what changes could be made to the current payment and settlement options to enhance attractiveness of EU CCPs and support the growth of EU-based clearing.

12. **Require segregated default funds:** respondents are also asked whether EMIR should be amended to require or further incentivise some EU-based CCPs to offer segregated default funds. Multiple default funds can be a welcome feature, as they can help avoid contagion and thus reduce financial stability risks, and so may make EU CCPs more attractive.

13. **Enhancing funding and liquidity management conditions:** the consultation asks whether the current range of options for funding, liquidity, collateral safekeeping/management, and investment are sufficient to support the growth of EU-based clearing, and if not, what can be done to enhance them.

14. **Interoperability:** under EMIR, explicit provisions for interoperability links relate to transferable securities and money market instruments. The consultation asks whether EMIR should explicitly cover interoperability arrangements for derivatives and whether there would be benefits from developing interoperability links between EU CCPs.

The consultation also asks respondents whether there are any other measures which could potentially help improve the competitiveness of EU CCPs.

Finally, the consultation asks whether current supervisory arrangements, whereby national competent authorities, with the involvement of EU-level bodies, supervise EU CCPs' compliance with EMIR, are appropriate. Respondents are asked to share their view on whether EU-level supervision should have a stronger role, and if so, what should this look like.

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