

EAPB Position Paper on Euro-Clearing

Abstract

The European Association of Public Banks (EAPB) welcomes the timely proposal for the reform of the Euro-Clearing rules under the EMIR Regulation. We consider this dossier highly important due to the upcoming departure of the United Kingdom from the European Union, with the threat of having the UK cut off the Single Market without any transition deal for financial services. While it is in the interest of the European economy that the clearing services remain in one place in London, the equivalence regime which will be applicable for the London-based services must warrant legal certainty and predictability for businesses. We also call on the legislators to take into account the protection of existing contracts.

I. General comments

This position paper is aimed to present the views of the European Association of Public Banks (EAPB) concerning the proposal of the European Commission of 13/06/2017 for a regulation amending the **European Market Infrastructure Regulation** (EMIR, Regulation EU 648/2012). The EAPB deems of paramount importance to elaborate solutions for managing the relations with third country CCPs. In particular, the grounds for a possible relocation of Euro-Clearing services need to be prepared.

We support the proposal of the EU Commission to reinforce, in principle, the supervisory regime for Central Counterparties situated in third countries. In case the EU and the United Kingdom do not succeed to agree on a sound supervisory practice, it could become necessary to accept settlement of systemically important CCPs with a high-risk potential in one of the Member States exclusively (new paragraph (2c) of Article 25). This can be necessary in crisis situations in order to assure stability of the financial market.

With a view at the existing derivative portfolios, clear rules and a performant technical environment must be the agreed conditions for any relocation of services. In addition, a transitional regime will be needed in order to safeguard the stability of markets. The impact of the measures should be weighed against the regulatory objective.

II. Specific comments

A) Ensuring financial market stability

CCPs are essential elements of the market infrastructure for both financial and non-financial counterparties. Supervisory arrangements must be in place enabling a direct access to CCPs in third countries by the ESA, including all necessary powers to take decisions in crisis situations. A failure of a CCP requires securing measures, in order to prevent impairment of the financial sector on one hand and of the real economy on the other. In a crisis situation, it is the EU that must be vested with full powers to take any reasonable rescue measure. Dependence on third countries must in no way give rise to doubts on the functioning of market infrastructures.

B) Practicability of equivalence rules

A row of EU equivalence decisions is in place that recognise the compatibility of a given third country regulatory framework with EU law. As of the moment of Brexit, the United Kingdom will be subject to such third country regimes. Those equivalence regimes however have obviously not been conceived in the aim to cover the major share of derivative clearing in Euro. When EMIR became applicable, there was no doubt that the main volume of OTC contracts would be executed in London - and thus in the EU - based on structures already in place.

Equivalence regimes must perform to warrant legal certainty, and predictability, to be a solid basis to business, and to make investments possible for improving market infrastructures. The regime must be shaped in a way to prevent any potential regulatory arbitrage by a given third country. The rather short timetable for Brexit negotiations (and regarding the slow progress of recent negotiations) gives rise to doubts whether a performant regulatory framework can be put in place in the UK, and be scrutinised in the light of equivalence requirements.

C) Fragmentation of the Clearing business

Relocation of high-risk systemically important CCPs into the EU risks contributing to market fragmentation. Fragmentation of the market would lead to liquidity shortfalls. A liquidity shortfall in a given area will likely imply higher costs for collateral. This again may trigger migration of clients from one area to another, also towards credit institutions that are not obliged to clear in the EU. The other way round, it is possible that extra European financial institutions might execute contracts using EU-based CCPs. Such possible scenarios are not predictable as of yet.

D) Transfer of derivative portfolios

EU-based CPs dispose already of comprehensive derivative portfolios vis-à-vis third country CCPs. In case a relocation of the Euro-Derivative-Clearing is considered, not only new contracts but also the existing volumes would need to be taken into account.

In case the Commission will reject authorisation under EMIR of systemically important CCPs, two scenarios will be conceivable: either the CCP would shut down its clearing services, or it might relocate its headquarters to the EU. Should, in addition to new business, a transfer of the existing portfolios to another service provider become necessary, then transfer rules would need to be created.

When drawing up such transfer rules, impact on accounting need to be anticipated as well as taxation aspects, also contractual documentation and liquidity-related questions. This is very important in order to prevent market turbulences and or disruptions that might be prejudicial to the real economy.

E) Protection of existing contracts, and transition rules

Event if it might not be achievable at the end of the day to create a regulatory framework for a transfer of derivative portfolios, ways must be found to avoid legal uncertainty. In such case it would be important to protect the state of existing volumes. Otherwise, a non-recognised CCP would risk to be classified as a usual OTC-contractor. This would imply extremely high capital requirements for the existing stocks, although collateral is in place. Therefore, the protection regime for existing volumes should foresee that third-country CCPs will be able to continue to comply with the EMIR requirements. Clearing through a CCP residing in the EU should be mandatory only for new contracts, and only after expiry of a reasonable transition deadline. Finally, EU-based Counterparties should continue to be able to steer risk positions towards third country CCPs in a suitable manner.

** The European Association of Public Banks (EAPB) gathers over 30 member organisations which include promotional banks such as national or regional public development banks and local funding agencies, public financial institutions, associations of public banks and banks with similar interests from 17 European Member States and countries, representing directly and indirectly the interests of over 90 financial institutions towards the EU and other European stakeholders.*