EMIR 3.0 – Commission proposal on derivatives clearing in Europe

- EAPB position -

General

The EAPB supports the European Commission's initiative to increase the attractiveness and resilience of the EU clearing landscape and, in general, the package of measures set out in the proposals for amending EMIR and related Regulations and Directives.

The changes introduced can roughly be grouped into four different, yet sometimes overlapping, categories:

- Active account-requirement and connected/supporting measures

The centrepiece is the introduction of a new obligation under EMIR to establish and maintain active clearing accounts with an EU-CCP and to clear a certain proportion of derivative contracts belonging to derivative classes deemed systemically relevant through these accounts (active account-requirement). The active account-requirement is supported by targeted complementary measures incentivising clearing in the EU, and also the introduction of new specific regulatory obligations and supervisory powers under the CDR and IFD compelling institutions to actively reduce their exposure towards third-country CCPs.

- Increased market transparency

In addition, the proposals introduce targeted measures aimed at increasing transparency for the supervisory authorities and market participants of certain markets and activities.

- Simplification of regulatory framework and procedures

They include a set of changes streamlining and simplifying certain regulatory requirements and procedures thereby reducing complexities and avoiding competitive disadvantages for EU market participants.

- General reform of regulatory framework for CCPs

They provide for a comprehensive restructuring and modernisation of the general regulatory framework for CCPs.

Key concerns and observations

1. Active accounts-requirement – new Art. 7a EMIR

An active account-requirement is an important and effective step to gradually increase clearing in the EU. It constitutes a key component of a long-term strategy to foster efficient, resilient and internationally competitive clearing markets within the EU. However, as regards the package of measures centering on or supporting active account-requirement, the following needs to be noted:

- The active account-based approach may appear to be less aggressive and intrusive than more direct measures forcing market participants to clear in the EU (forced relocation). However, while the proposal indicates that the requirement is to be phased-in over time, it fails to provide clarity regarding the specifics, and in particular the manner of the phase-in, the proportion of derivative contracts eventually expected to be cleared in the EU and necessary exemptions. Thus, unless very carefully designed, calibrated, and applied, this active account-requirement can, in effect, amount to a forced relocation with lasting and very damaging ramifications for EU market participants and EU financial markets. In this context it should be taken into account that many non-EU-institutions have full access to the EU markets while retaining access to international markets without any of the restrictions and limitations under the EU regulatory regime allowing them to offer clients the full range of clearing options on all international markets.

- Neither this active accounts-based approach nor more aggressive direct measures can overcome the core challenge to establishing a fully viable, balanced and competitive EU clearing market, which is the fact that even the liquidity in EUR denominated derivatives contracts is primarily and by a large part provided by non-EU market participants: This disparity between the share of the market liquidity generated by EU and non-EU-market participants means that a forced relocation or measures amounting thereto will always result in a structurally unbalanced and significantly less liquid EU-clearing market and can also effectively cut-off EU institutions from international markets and business.

We therefore strongly urge for certain adjustments and clarifications to ensure that the package of measures intended to make clearing in the EU more attractive and to increase the resilience of the EU clearing market does not achieve the opposite of its intended purpose and also severely reduces the international competitiveness of the EU financial markets and financial institutions.

a) Design, calibration, implementation of active accounts-requirement

The active account requirement as currently proposed includes the obligation to clear a certain proportion of derivatives transaction in derivatives classes deemed systemically important via an EU-authorised (and thus EU-based CCP). The concrete design and metrics for determining this proportion as well as the applicable calculation methods are to be set via regulatory technical standards (RTS).

The RTS-based approach provides for a way to adequately ensure that certain activities necessarily associated with an institution's participation in international markets and memberships with third-country market infrastructures can be disregarded in the calculations or are otherwise excluded. These activities are essential to safeguard the continued access to and competitiveness of an institution in international markets. It also must be taken into account that the decision whether and where to clear is always made by the client and not the clearing service provider. Especially non-EU clients are unlikely to clear via EU-CCPs as they usually have multi-currency portfolios which currently cannot be served with the same breadth and liquidity by EU-CCPs.

In addition, legacy contracts which have been accepted for clearing before the entry into force of the new requirements also need to be excluded from the scope of the obligations. To avoid uncertainties and disruptions, the exclusion from the scope of legacy transactions should be expressly addressed in the amending Regulation itself.

It will be important to recognise the limits of what can be achieved by regulatory means in view of the disparity of the liquidity existing on international level and within the EU. The overarching goal thus must be a fully viable, balanced, and competitive EU clearing market while avoiding any short-term measures fundamentally harming the international competitiveness of EU-institutions and financial markets.

Likewise, to prevent a distortion of competition between EU-institutions and on an international level, it will be necessary that supervisory authorities apply the active account-requirement consistently and in a coordinated manner with due consideration of the business models of the institutions.

b) Material scope

- EUR-CDS: Reconsideration of systemic importance

The classification of EU-CDS clearing via ICE Europe Limited as systemically important will need to be reconsidered following the recent announcement by ICE Europe Limited to phase-out the relevant clearing activities.

- EUR STIR and PLN-IRS: Unsuitability because of lacking liquidity

The markets in PLN-IRS and EUR-STIR are significantly less broad and liquid than the EUR-IRS markets. They are also of limited systemic relevance.

The active account-requirement is likely to produce split markets for the affected derivatives categories and there is a clear risk that this will result in a balanced and liquid non-EU market and a less balanced and significantly less liquid EU-market. This risk will be particularly pronounced in case of these significantly less-liquid derivatives categories. The inclusion of PLN-IRS and EUR-STIR in the scope of the active accounts-requirement should therefore be reconsidered.

c) Timelines

The objective to strengthen clearing in the EU must be a long-term project. Accordingly, the timelines to be set need to be realistic and cannot be too ambitious and rigid. The upcoming changes to the clearing framework in the EU will require considerable operational changes and preparations. All this means that market participants will need sufficient lead time. It is also already clear that the time until the scheduled ending of the current extension of the equivalency decision in June 2025 will not be sufficient for the introduction of the operational changes and the necessary adjustments by market participants and not for seeing the impact of the active-accounts requirement on the markets. Consequently, there will be need for an extended transition period requiring a further extension of the equivalence decision. As market participants need certainty and clarity, this should be addressed in the Amending Regulation.

2. Exposure reduction planning and target setting obligation for institutions – Art. 76(2) CRD/Art. 29(1) IFD and corresponding new supervisory exposure reduction enforcement power – Art. 104(1)(n) CRD/Art. 39(2)(b) IFD

The obligation to develop specific plans and set targets for a reduction of the concentration risk towards third-country CCPs in systemically relevant derivatives categories, together with a new supervisory power to actively enforce an exposure reduction by requiring an institution to "realign" or reduce their positions where deemed an excessive concentration risk, is a very aggressive and invasive tool which can result in significant interferences with core business activities of an institutions, client relations and the business model of an institution, and its general competitiveness.

Against this background and especially since the explanatory memorandum for the proposal of the Amending Directive itself states that the competent supervisors already possess powers to adequately address excessive concentration risks under the existing CRD-framework, the introduction of such new far-reaching and potentially very intrusive obligations and powers should be reconsidered.

At the very least it would need to be ascertained that such new obligations and powers will be applied with utmost care, full consideration of the business model of and the potential implications for the business activities of the relevant institution and in all material aspects consistently and in a coordinated manner across the EU to prevent a distortion of competition and other harmful effects. Should these new regulatory requirements and enforcement powers under the CRD and IFD indeed be introduced despite the above concerns it would specifically be necessary to clearly set out in the Amending Regulation and Amending Directive how these new requirements and powers under the CRD and IFD regime are supposed to interact with the active accounts-requirement under the parallel EMIR regulatory regime, especially considering the potentially diverging regulatory objectives (strengthening of EU-clearing in case of EMIR and reduction of concentration risks in case of the CRD and IFD). It is vital that the necessary exemptions regarding market-making activities, non-EU client clearing and legacy transactions regarding the EMIR based active accounts-requirement (see above) are also fully recognised and incorporated into CRD and IFD based requirements concerning the reduction of concentration risk to avoid a fundamental regulatory divergence and severe and lasting adverse effects for the international competitiveness of EU institutions.

Without full recognition/alignment of the relevant exemptions and clear rules on the interaction between the two separate regulatory regimes, metrics and thresholds would be set independently by different regulators with potentially very significant differences in the outcomes. The existence of two separate regulatory regimes with differing objectives and separate enforcement powers is also likely to cause additional duplicative and even conflicting regulatory burdens for market participants.

A further unresolved question is, how these new regulatory powers under the CRD and IFD are intended to address concentration risks vis-à-vis EU-CCPs and how this can be aligned with the objectives of the EMIR regime.

In any event we understand that – since these obligations and powers are intended to reduce concentration risks – institutions will be able to address any excessive concentration identified by the supervisory authority by spreading their exposure across various CCPs, including other third-country CCPs.

3. New reporting obligations regarding calculation outcomes and third-country CCP clearing activity– new Art. 7a(4) and new Art. 7b(2) EMIR

The introduction of another new annual reporting obligation regarding calculation and third-country CCP exposure is unnecessary in view of the already existing EMIR reporting obligations. If retained, it should at least be limited to key information not already available through the existing reporting obligations to trade repositories. In case of the CCP-exposure reporting obligation it is also unclear what the terms "other financial instruments or non-financial contracts" or "largest payment obligation" intend to capture and why such information is needed for the purposes of the active accounts-requirement.

4. Client information on alternative EU clearing possibilities – new Art. 7b(1) EMIR

The current proposal can be read to require a trade-by-trade information obligation. This would fundamentally conflict with the existing established clearing processes and workstream which do not allow for the provision such specific information on a trade-by-trade basis. Such an understanding would therefore require far reaching procedural changes which would cause significant delays and inefficiencies. Clearing clients are professional market participants and thus very much aware of the set-up of the clearing markets and possible alternatives and therefore do not need a trade-by-trade reminder. It should therefore be clarified that the obligation for clearing members and clients offering clearings services both via EU and 3rd country CCPs to inform clients of the possibility to clear via an EU-CCP can be implemented in general form.

In addition, where derivative transactions are entered into on a trading venue, the CCP is fix and there is no alternative clearing possibility. Hence, these transactions should be excluded from the information requirement.