

MEMO# 31755

May 10, 2019

European Parliament and Council Adopt Overhaul of CCP Supervision with Amendments to EMIR

[31755]

May 10, 2019 TO: Derivatives Markets Advisory Committee
Equity Markets Advisory Committee
ICI Global Trading & Markets Committee
Securities Operations Advisory Committee RE: European Parliament and Council Adopt Overhaul of CCP Supervision with Amendments to EMIR

The European Parliament and Council recently adopted extensive amendments to the supervisory regime for central counterparties (CCPs) under the European Market Infrastructure Regulation (EMIR).^[1] The Amendments have significant implications for all CCPs that operate in the European Union, especially those that are established in third countries and rely on EMIR's recognition framework to provide clearing services in the Union.^[2]

The EU's framework for supervising CCPs presently relies mainly on home-country authorities to enforce the provisions laid out in EMIR. This fragmented supervisory scheme has resulted in "[d]iverging supervisory practices for CCPs" across the European Union and raises the potential for "regulatory and supervisory arbitrage," which could lead to "unhealthy competition."^[3]

The Amendments aim to standardize CCP supervision by providing ESMA with a greater role in the authorization and oversight of clearinghouses operating in the Union.^[4] The Amendments also provide for greater oversight of all third-country CCPs based on the notion that in an interconnected, cross-border financial system, European authorities should oversee third-country CCPs that operate within the EU. The Amendments also include a mechanism to require a third-country CCP to relocate to the European Union to provide clearing services within the Union if EU authorities determine the CCP poses too much risk to the Union or any Member State(s).

Establishment of CCP Supervisory Committee and Enhanced Collaboration Requirement

The Amendments direct ESMA to establish a CCP Supervisory Committee to handle EU-level tasks related to CCP supervision and to coordinate among competent authorities to build a

common supervisory culture and consistent supervisory practices across the European Union.^[5] The CCP Supervisory Committee will include permanent members and members specific to CCPs. The permanent members will include a Chair and two independent members, each of which will be voting members. The CCP-specific members include representatives of the national competent authority of a member state where the CCP is authorized and representatives of the relevant central banks of issue that have requested membership.^[6] The CCP Supervisory Committee will provide a mechanism for ESMA to opine on draft decisions of national competent authorities relating to the registration of EU CCPs and to recognize (or recommend denial of recognition for) third-country CCPs.^[7]

Where ESMA determines that a third-country CCP poses or could pose systemic risk to the EU financial system, the Amendments also require consultation with central banks of issue regarding decisions to be taken on issues such as margin requirements, liquidity risk controls, collateral requirements, settlement, and others.^[8]

Expansion of Supervisory Arrangements for Third-Country CCPs Offering Clearing Services in the European Union

Differentiating Between Systemically Important and Non-Systemically Important CCPs

The Amendments aim to enhance the supervision of third-country CCPs offering clearing services in the EU by differentiating between lower risk, non-systemically important third-country CCPs (Tier 1 CCPs) and third-country CCPs that are or are likely to become systemically important for the EU or one of its Member States (Tier 2 CCPs).^[9] ESMA must classify a CCP as a Tier 1 or Tier 2 CCP when the CCP applies for recognition using the following objective criteria:

- The nature, size, and complexity of the CCPs business in the European Union, and outside the European Union to the extent its business may have a systemic impact on the Union or on one or more of its Member States;
- The effect that the failure of or a disruption to the CCP would have on: (1) financial markets, including the liquidity of the markets served; (2) financial institutions; (3) the broader financial system; or (4) on the financial stability of the European Union or of one or more of its Member States;
- The CCP's clearing membership structure including, to the extent the information is available, the structure of its clearing members' network of clients and indirect clients established in the European Union;
- The extent to which alternative clearing services provided by other CCPs exist in financial instruments denominated in EU currencies for clearing members, and to the extent the information is available, their clients and indirect clients established in the Union; and
- The CCP's relationship, interdependencies, or other interactions with market participants and the financial system.^[10]

The Amendments direct the European Commission (Commission) to clarify these criteria with a delegated act within twelve months after the Amendments enter into force.^[11]

Adjustments to the Process for Recognizing Third-Country CCPs

EMIR allows ESMA to recognize a third-country CCP to provide clearing services in the European Union if it determines that the CCP is subject to "effective supervision and

enforcement” in the third country.^[12] The Amendments continue this practice, but they empower the Commission to make recognition decisions conditional on the CCP or its third-country supervisory regime meeting certain requirements.^[13] Prior to the adoption of the Amendments, EMIR did not contemplate conditional equivalence.

The Amendments also impose additional recognition criteria on Tier 2 CCPs. Pursuant to the Amendments, ESMA must notify a CCP applying for recognition whether it is considered a Tier 1 or Tier 2 CCP within 30 working days of the determination that the CCP’s application is complete. If ESMA determines that the applicant is a Tier 2 CCP, the Amendments specify that the applicant must meet the following conditions—which do not apply to Tier 1 CCPs—to receive recognition to provide clearing services in the European Union:^[14]

- The CCP complies, on an ongoing basis, with prudential requirements for EU CCPs, including those related to capital, business conduct, margin, financial resources, and liquidity;^[15]
- Relevant central banks have provided written confirmation that the CCP complies with any conditions imposed by the bank(s) to facilitate their ability to carry out their monetary policy tasks; and
- The CCP provides ESMA with a written statement expressing the unconditional consent of the CCP to: (1) provide within three working days after a request any documents, records, information, and data held by that CCP; and (2) allow ESMA to access any of the CCP’s business premises and to provide a reasoned legal opinion by an independent legal expert confirming that the consent expressed is valid and enforceable under the relevant applicable laws.^[16]

Additionally, the Amendments require ESMA to review the recognition of a third-country CCP any time such CCP intends to extend or reduce the range of its activities or services in the Union, in which case it shall inform ESMA by submitting all necessary information. Regardless of a CCP’s intention to vary the range of its operations, ESMA shall conduct a review of the CCP’s status at least every 5 years.^[17] If ESMA determines that a third-country CCP classified as a Tier 1 CCP should instead be classified as a Tier 2 CCP, ESMA shall set an appropriate adaptation period, not to exceed 18 months, within which the CCP must comply with the full spectrum of conditions applicable to Tier 2 CCPs.^[18]

The Amendments also introduce a system of “comparable compliance” that would allow a Tier 2 CCP to request that ESMA determine that third-country regulation provides a comparable outcome to EMIR.^[19] If ESMA finds comparable compliance exists, it may waive the application of the relevant EMIR provisions. The Commission must adopt a delegated act within a year of the Amendments entering into force to specify how ESMA will carry out a comparable compliance determination.^[20]

Location Requirement for Tier 2 CCPs

The Amendments allow ESMA and relevant EU central banks to determine that a Tier 2 CCP poses or could pose such a large risk to the financial stability of the European Union or a member state that the CCP or some of its clearing services should not be recognized in the EU. In reaching this conclusion, ESMA must: (1) explain how compliance with the conditions for Tier 2 CCP recognition (described above) would not sufficiently address the financial stability risk for the European Union or for one or more Member States; (2) describe the characteristics of the clearing services provided by the CCP; and (3) provide a quantitative technical assessment of the costs and benefits and consequences of the decision not to recognize the CCP, taking into account the existence of potential alternatives and the

potential consequences of interrupting the outstanding contracts held at the CCP.[21]

If the Commission agrees with this determination, it may, as a measure of last resort, adopt an implementing act specifying that some or all of the clearing services of that Tier 2 CCP can only be provided after the CCP relocates to the European Union (i.e., is authorized and established in a Member State). ICI Global objected to this relocation requirement when this legislation was initially proposed and urged EU authorities instead to require substantially systemically important CCPs to comply with EMIR rather than granting recognition.[22] EU policymakers unfortunately declined to take this suggestion.

Third-Country CCP College

The Amendments direct ESMA to establish a third-country CCP college to facilitate information sharing and cooperation between ESMA, the Member States' competent authorities responsible for CCP supervision, and the competent authorities responsible for supervision of entities on which the operations of the third-country CCPs might have an impact.[23] The college will consist of the Chair of the CCP Supervisory Committee, the two independent members of the Committee, and representatives of the competent authorities responsible for supervision of CCP's and related entities established in or which affect the European Union.

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endnotes

[1] Regulation (EU) No 2019/... of the European Parliament and of the Council amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs, dated April 10, 2019, *available at* http://www.europarl.europa.eu/doceo/document/A-8-2018-0190-AM-002-002_EN.pdf (Amendments).

[2] See Regulation (EU) No 648/2012 (EMIR) at Article 25.

[3] See Amendment at Recital 6.

[4] The Amendments also provide European central banks more input into CCP supervision. This increased role reflects EU policymakers' view that central banks, as issuers of currency, should have a greater role in CCP oversight. EU policymakers are considering changes to the ECB statute that would give the ECB the power to impose additional requirements on systemically significant third-country CCPs in exceptional circumstances.

[5] These tasks include conducting a yearly analysis of the supervisory activities of all competent authorities in relation to the authorization and supervision of CCPs, initiating and

coordinating an annual, Union-wide assessment of the resilience of CCPs to adverse market developments, and promoting regular exchange and discussion among competent authorities related to CCP supervision. See Amendments at Article 1(9)(5)-(8).

[6] See Amendments at Article 1(9) (inserting new Article 24a of EMIR). The designated representatives of the competent authorities from each Member State shall together be considered as one voting member, while the representatives of the central banks that have requested membership shall be non-voting.

[7] See Amendments at Article 1(7) (inserting new Article 23a of EMIR).

[8] Amendments at Article 1(9) (inserting new Article 24b of EMIR).

[9] Amendments at Article 1(10) (amending Article 25 of EMIR).

[10] See Amendment at Article 1(10) (inserting new paragraph 2a to Article 25 of EMIR).

[11] The Amendments shall enter into force 20 days after publication in the Official Journal of the European Union. Amendments at Article 2.

[12] See Article 25 of EMIR.

[13] Amendments at Article 1(10) (inserting new paragraph 6 to Article 25 of EMIR).

[14] Tier 2 CCPs also must meet a set of more general conditions that apply to any third-country CCP seeking recognition under EMIR. These conditions include: (1) the adoption of an implementing act by the Commission; (2) the CCP is subject to effective supervision and enforcement in a third-country; (3) cooperation arrangements have been established; and (4) the CCP is established and authorized in a third-country that has equivalent systems for prohibiting money-laundering and combating the financing of terrorism as those of the Union. See Article 25(2)(a)-(d) of EMIR.

[15] These requirements are set out in Article 16 and Titles IV and V of EMIR. The final amendment requires ESMA to consult the central banks of issue regarding a CCP's compliance with Articles 41 (margin), 44 (liquidity risk controls), 46 (collateral), 50 (settlement), and 54 (interoperability arrangements).

[16] See Amendments at Article 1(10) (amending Article 25 of EMIR to enhance ESMA's supervisory toolbox to facilitate its greater oversight responsibilities for third-country CCPs by adding new powers to access information, conduct investigations and on-site inspections, and punish CCPs that violate EMIR by refusing to grant recognition). Each Tier 2 CCP would be required to confirm that it satisfies these requirements at least annually under new Article 25b of EMIR.

[17] Amendments at Article 1(10) (replacing paragraph 5 Article 25 of EMIR).

[18] Amendments at Article 1(10).

[19] See Amendments at Article 1(11) (inserting new Article 25a of EMIR).

[20] Amendments at Article 1(11) (inserting new paragraph 3 to Article 25a of EMIR).

[21] Amendments at Article 1(10) (adding new paragraph 2c to Article 25 of EMIR).

[22] See Letter from Dan Waters, Managing Director, ICI Global, to the Directorate-General for Financial Stability, Financial Services and Capital Markets Union, European Commission, dated October 23, 2017, *available at* <https://www.iciglobal.org/pdf/30921a.pdf>.

[23] See Amendments at Article 1(11) (inserting new Article 25ba).

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