

Comments

on the proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1095/2010 and 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

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 1,700 banks.

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I. General observations

The German Banking Industry Committee supports the proposal for a new framework for the enhanced supervision and for the introduction of new supervisory powers of central counterparties (CCPs), especially third country CCPs, submitted by the Commission on 13 June 2017¹ in order to further improve the stability of the European financial markets and, specifically, the stability of CCPs as critical market infrastructures.

The new regulatory framework set out in the proposal is clear and consistent by addressing key issues and focussing on the overarching principle of safeguarding and improving stability. It provides for an effective set and wide-range of tools to address these issues both as regards the future regulatory structure and as to the powers and instruments available to these regulatory authorities.

The proposal is, furthermore, based on sound and clear objectives in that it aims to provide for a balanced and flexible framework that establishes a significantly enhanced and even more robust system of supervision of systemically important CCPs established in the EU as well as in third countries, while at the same time enabling the competent authorities to pursue a targeted, measured and proportionate exercise of the powers granted to them under this new framework.

A measured and targeted approach will be of the essence in order to ensure that all measures taken under the new framework are commensurate to the risks and systemic importance of the relevant CCPs, and do not have unintended consequences, which may ultimately undermine the underlying objective of maintaining or increasing the stability of the European financial markets.

Having said this, it should be considered to address the following two issues with more detailed provisions in order to avoid uncertainties and prevent unintended consequences:

- Ensuring that the framework provides for appropriate powers and procedures to ensure that the immediate and indirect consequences of any decisions taken will be recognised and addressed, in particular in order to safeguard that market participants have sufficient certainty over the extent to which they will be affected by the decision and are also afforded adequate time to make any necessary adjustments.
- Safeguarding the appropriate participation of the regulatory and supervisory authorities of member states, within the supervisory and regulators structure.

The above-mentioned issues and underlying concerns are set out in more detail in the subsequent section with comments on certain elements of the proposal:

¹ Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and 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 (draft amendment regulation regarding the authorization of CCPs and recognition of third country CCPs)

II. Comments on certain elements of the proposal

1. Reorganisation of supervisory structure – Art. 1 (amendments to Regulation (EU) No 1095/2010 – ESMA-Regulation: new Art. 44a (1) (b))

We agree that the existing supervisory structure needs to be reviewed to some extent in relation to third country CCPs and we also recognise that it would be generally consistent and appropriate to seek a greater degree of uniformity and centralisation of the regulatory powers. However, we believe that the national regulatory and supervisory authorities of the member states need to continue to play a central role within this new system and the decision making process. Furthermore, we support the German government's position that the two parts of the dossier, i. e. the regulation of third country CCPs on the one hand and the supervision of CCPs, which needs to be aligned with the review of the European Supervisory Authorities (ESAs), on the other hand, should be closely coordinated.

Only the involvement of the national authorities will ensure that their understanding of the relevant markets and their vital expertise - especially regarding the legal framework - will be sufficiently taken into account in all decisions made. One practical example would be the question whether the relevant asset protection mechanisms of a CCP is compatible with the laws of the member states so that market participants are not exposed to legal uncertainties and risks. The participation of national authorities also ensures that the regulatory and supervisory system continues to profit from their direct line of communication with market participants. This direct line of communication is vital to ensure a comprehensive and early information of market participants. It also safeguards that information on new issues and developments in the local markets are identified as early as possible.

The input from national regulatory and supervisory authorities is of particular importance in order to avoid that decisions on the application and interpretation of certain elements of the regulatory framework cannot be implemented because of existing legal differences between the applicable laws.

Against this background, we believe that the competent national regulatory/supervisory authorities should continue to have a central role in the oversight over CCPs established within the EU.

As regards third country CCPs, the main responsibilities will of course need to be centralised on EU level. However, the regulatory/supervisory authorities of the member states will nevertheless need to be included in the decision making process on this level since decisions regarding third country infrastructures will often have a significant impact on markets in member states.

2. New framework for the recognition of third country CCPs– Art. 2 (amendments to Regulation (EU) No 648/2012 – EMIR: new Art. 25 (2a) to (2c))

We support and agree with the general approach and key elements of the proposed new framework for the recognition and supervision of third country CCPs for the reasons already stated above in our general observations.

We particularly understand and share the view that it is necessary to ensure comprehensive regulatory oversight over all CCPs, which are of particular systemic importance for the EU in view of the central role CCPs have in the new financial market infrastructure and the potential risks for the stability of European financial markets as well as for all market participants (both financial and non-financial counterparties) in the event of a failure of a CCP. Regulatory gaps and arbitrage need to be avoided. Consequently, the present equivalency approach can be insufficient so that the regulatory framework for such systemically important CCPs has to provide for further and more far-reaching rights and powers to safeguard the stability of the EU financial markets.

Specifically, we support

- the suggested two-tiered approach, distinguishing between non-systemically important CCPs and systemically important CCPs;
- the general criteria set out in the new Art. 25 (2a) EMIR to be applied in order to determine whether a third country CCP is to be classified as systemically important; these criteria are, of course, to be further specified by a delegated act (ITS/RTS);
- the criteria set out in the new Art. 25 (2b) EMIR to be applied to determine whether a recognition of a systemically important third country CCP is merited and are appropriate, including the requirement to involve the central bank at issue in the process;
- providing for the possibility to reject the recognition of a third country CCP under very specific circumstances, or to demand authorisation as a CCP established in the EU in accordance with Art. 14 EMIR – thus effectively requiring a relocation of the relevant CCP in question as set out in new Art. 25 (2c) EMIR.

Having said this, any decision taken should be based on a careful analysis and by taking into account the possible implications such a decision will have for market participants and the financial markets of the EU as a whole. Careful consideration of the implications will, of course, be particularly required with regard to any decision taken in relation to CCPs currently already used by a significant section of European market participants. The most pertinent example will, of course, be the CCPs established in the United Kingdom (UK), which have already been authorised as EU-CCPs, but which – upon impending withdrawal of the UK from the EU and failing an immediate equivalency decision of the Commission in accordance with the new Art. 25 (6) EMIR in respect of the (post-withdrawal) UK supervisory framework for the authorisation of CCPs – will presumably require recognition as third country CCP.

Market participants relying on the services of these CCPs will need to be assured that any decision to be made in relation to these CCPs under the proposed new framework takes into account the potential impact on market participants and markets as a whole, and also provides for effective and adequate measures and processes, which prevent or at least limit unintended consequences and detrimental effects on market stability. In particular, market participants would need sufficient certainty both over the extent to which any decision affects them as well as with regard to the applicable timeline in order to allow the necessary advance planning and implementation of any adjustments required in reaction to such a decision and the new situation. This will, of course, be particularly relevant with regard to the end of the two-year negotiation period between the European Union and the United Kingdom under Art. 50 of the Treaty on European Union in March 2019. Correspondingly, the regulatory authorities will need to be afforded the requisite powers (with considerable room for discretion) in order to implement the decisions in a manner that prevents or at least limits unintended consequences and detrimental effects on market participants and market stability as far as possible and also provides for a clear and ordered transition process (in particular adequate transition periods).

In this decision making process and, in particular, when determining and structuring the implementation and transition process, the following aspects will need to be considered and addressed in order to avoid unintended consequences:

- Interruption of established links to CCPs and requirement to establish new links

The potential consequences of a failure to be recognised or the imposition of the requirement to relocate on an existing CCP currently used by European institutions could be particularly serious for counterparties that do not already have access to a CCP within the EU. Many European clearing members and their clients have been relying on UK-CCPs for quite some time. They have established the necessary links with these CCPs by setting up the requisite processes, operational and technical infrastructure and the legal framework (such as contractual arrangements and legal review processes). Many have cleared and continue to clear nearly all or at least significant portions of their derivative transactions via these CCPs. Under these circumstances, a rejection of a recognition would disrupt existing clearing operations for these market participants and also, indirectly, the wider market: In order to remain compliant with the clearing obligation under EMIR and also to avoid punishing capital requirements under the existing European prudential requirements and European market participants, especially those which currently only have access to UK-CCPs or use UK-CCPs for the vast majority of their transactions would need to establish alternatives in a very short time. However, the process of establishing an alternative access alone will be very challenging for all parties involved. Experience with the implementation of the clearing obligation so far have demonstrated that establishing access to a CCP is very time consuming and operationally complex for the market participants, especially the clients.

- Fragmentation of markets and impact on liquidity and costs

Market participants accessing existing UK-CCPs currently also benefit from the deep liquidity resulting from the wide range and international character of the membership and client base. This advantage translates into considerable cost effects. The fragmentation of the markets to be expected if EU-market participants were no longer able to access a major CCP and the depreciation of the liquidity as a consequence thereof could significantly increase cost for them and the wider market. However, to what extent cost effects could materialize depends on a variety of variables and thus are difficult to determine.

- Temporal scope of the decision (retroactive effect or limitation to future transactions)

As already mentioned above, the vast majority of OTC-derivative transactions of EU market participants are currently cleared by UK-CCPs. This means that EU market participants are currently holding very substantial derivative positions vis-à-vis UK-CCPs. The above described challenges arising in the event of an abrupt loss a recognition as third-country CCP or the rejection of a recognition would be vastly more challenging if it were to affect not only all future but also the already existing positions (legacy transactions). Should legacy transactions of clearing members from the EU not be exempted, they either would have to be transferred ("port") to another authorised/recognised CCP (including a transfer and posting of collateral) or, alternatively, terminated. However, it is currently uncertain whether such transfer or termination will be legally and practically possible in all cases (especially in short time) as the European counterparties would need to have the requisite contractual rights to port/terminate the relevant positions (including the release of collateral) and/or require the consent and active cooperation of all involved parties. Furthermore, any transfer (porting) of existing positions would, in any event, effectively require the reconstitution (novation) of each of the transactions to be transferred as well as a reposting or transfer of collateral. The sheer scale of the exercise and volume of the transactions and collateral affected would make this extremely challenging and could also have a noticeable impact on the financial markets. The process would also be fraught with very real operational risks. Furthermore, this could have considerable financing implications. In addition to the abovementioned, further challenges are liquidity aspects that have to be taken into account. It would also have to be ensured that the remaining authorised or recognised CCPs have the capacity to absorb all legacy transactions as well as all future transactions to be cleared (especially at short notice). For example, there would need to be a sufficiently large pool of clearing members prepared to accept the relevant counter position to all transferred transactions. At present, it is not clear to what extent international market participants, which currently contribute significantly to the liquidity of existing CCPs, will become clearing members of these CCPs or increase their positions and exposure accordingly. Moreover, the relevant CCPs would have to adapt and expand their product portfolio, and would have to review and adjust their operational infrastructure accordingly. Against this background, we believe that any decision to reject a recognition affecting legacy transactions would need to be accompanied by a comprehensive analysis of the potential impact and adequate regulatory implementation measures and advance preparation, including adequate transition periods. In any event, it needs to be clarified that any decision should only affect new transactions (grandfathering).

- Transition periods

Market participants (in particular clients and indirect clients) will need sufficient preparation time to establish new links to a CCP. Likewise, the CCPs will also need sufficient time to make changes to their internal structures and operational set up to absorb new members and transactions and – where necessary – obtain regulatory approval to any changes made. Consequently, the new regulatory framework therefore needs to provide the regulatory authorities in the EU with the necessary (and sufficiently broad) powers to establish a transition regime allowing for an ordered and structured transition process. Such powers will be particularly important with regard to the very real possibility of a CCP currently used by a significant section of EU market participants losing its authorisation or recognition abruptly and/or without an adequate transition plan.