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# Responding to challenges for critical financial market infrastructures and further developing the Capital Markets Union

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## 1/ Introduction

The financial crisis demonstrated that the lack of transparency in the derivatives sector and the complex interdependence between financial market participants increased uncertainty in times of stress and posed risks to global financial stability. In 2012, based on the decisions taken by the G20 in 2009 in response to the financial crisis, the EU adopted the European Market Infrastructure Regulation (EMIR) to address these concerns by regulating Central Counterparties (CCPs), ensuring consistency of CCPs' supervisory oversight via colleges of supervisors including relevant national supervisors and the European Securities and Markets Authority (EMSA), and requiring standardised over-the-counter (OTC) derivatives to be cleared in CCPs. Since then, CCPs have gained an increasingly central role in capital markets in Europe. Today, the European Commission adopted a proposal for a first set of amendments to EMIR. The objective of that proposal is to reflect the experience gathered during the first years of application of EMIR by making the application of the Regulation simpler and more proportionate in certain areas and to create further incentives for CCPs to offer central clearing of derivatives to counterparties in order to make the financial system even safer.

Beyond today's proposal the Commission is of the view that, in view of the challenges in the area of derivatives clearing, further changes will be necessary to improve the current framework that ensures financial stability and supports the further development and deepening of the Capital Markets Union (CMU).

## 2/ Context and current challenges

Clearing derivatives transactions is a global financial service. As such, most clearing is done across borders, both within the EU and internationally with CCPs established in third countries. The scale and importance of CCPs in Europe and globally has nearly doubled since the post-crisis G20 commitment to clear standardised OTC derivatives through CCPs. On average 62% of their outstanding value was centrally cleared by CCPs across all types of derivative contracts[1]. More specifically, the Bank for International Settlements estimated that the volume of cleared OTC transactions at the end of June 2016 amounted to $337 trillion globally, of which the large majority ($328 trillion) are interest rate derivatives. The growing importance of clearing and the corresponding increasing volumes present challenges which are widely recognised by governments and public authorities.

EU CCPs are already well-regulated and have robust resources to deal with financial distress under EMIR. Moreover, the Commission's proposal of December 2016 for a regulation on the recovery and resolution of CCPs[2] provides a toolbox to manage the remote possibility of a CCP entering into difficulties.

Nevertheless, the growing systemic importance of CCPs for the EU and the inter-linkages to the financial system as a whole underline the need to enhance the current supervisory arrangements which currently rely on a central role for the home Member State with

[1] BIS, Statistical release, OTC derivatives statistics at end-June 2016, November 2016.
[2] COM (2016) 856 final – 2016/0365 (COD)

coordination in EU-colleges of national authorities with the participation of ESMA. This is particularly the case as clearing services are strongly concentrated in a limited number of CCPs across the world and in the EU, thereby increasing the importance of the most significant CCPs for the financial stability and market functioning of all Member States beyond that of the home Member State that authorised and supervises a CCP.

In this context, the foreseen withdrawal of the United Kingdom from the EU will have a significant impact on the regulation and supervision of clearing in Europe. At present, as much as 75% of euro-denominated interest rate derivatives are cleared in the UK. Derivatives denominated in some other Member States' currencies are also cleared in the UK. These transactions directly impact the responsibilities, including in the area of monetary policy, of the relevant EU and Member State institutions and authorities.

**3/ Further steps to ensure safety and soundness of CCPs**

Enhanced supervision

Overcoming the fragmentation of the EU regulatory framework along the lines of national borders and promoting the efficiency and effectiveness of the European clearing and settlement systems was already identified in the November 2001 Giovannini Report. The EMIR Regulation greatly contributed to this by providing a single consistent and comprehensive set of rules that apply in the Single Market, and represent a basis for further supervisory convergence.

In the context of the development of the CMU, the Commission is considering how more integrated supervision by the supervisors and responsibilities of the central bank issuing each relevant currency (central bank of issue) of financial market infrastructures and market participants at EU level can support the development of deeper and better integrated capital markets. The urgency of further developing and integrating EU capital markets was stressed already in both the Communication on CMU of September 2016[3] and in the ongoing consultation on the operations of the European Supervisory Authorities (ESAs).[4]

Strengthening the supervisory functions and the responsibilities of the central bank of issue at European level is at the heart of these efforts given their central role in accelerating market integration and eliminating regulatory arbitrage or a race to the bottom. Critical capital market functions whose sound performance and effective supervision is central to the functioning of capital markets call for more centralisation of supervision. Therefore, adaptations to the legal framework in relation to supervision by the European Securities and Markets Authority (ESMA), and in relation to the responsibilities of the central bank of issue are necessary. Consideration must be given amongst other things to authorisation of CCPs and ongoing supervision at EU level, for instance by means of monitoring financial resources and liquidity risk.

[3] Communication on the "State of the Union 2016: Completing the Capital Market Union – Commission accelerates reform"; 14 September 2016; IP/16/3001
[4] Public consultation on the operations of the European Supervisory Authorities"; 21/03/2017 – 16/05/2017

Such future adjustments and enhancements in the regulatory set-up would also need to be appropriately reflected in the pending legislative proposal on CCP Recovery and Resolution, referred to above, which brings a more coordinated EU mechanism to respond to the unlikely event of a failure by a CCP, provides a toolbox for future resolution authorities and is currently being discussed with the European Parliament and the Council. The Commission stands ready to engage with the co-legislators on this important matter.

Third-country CCPs

Clearing markets are closely integrated internationally. This is particularly relevant as, following the foreseen withdrawal of the United Kingdom from the EU, a substantial volume of transactions denominated in euro would cease to be cleared in the EU and would no longer be subject to EMIR and the EU supervisory architecture. Derivatives denominated in some other Member State currencies are also cleared in the UK.

The Commission remains committed to integrated financial markets, its international obligations, and the possibility of equivalence for CCPs, and is conscious of the need to avoid undue fragmentation of the global system. However, also taking into account as necessary relevant experience from other jurisdictions, specific arrangements based on objective criteria will become necessary to ensure that, where CCPs play a key systemic role for EU financial markets and directly impact the responsibilities, including financial stability and monetary policy, of EU and Member State institutions and authorities, they are subject to safeguards provided by the EU legal framework. This includes, where necessary, enhanced supervision at EU level and/or location requirements.

## 4/ Conclusion

In light of the considerations set out in this Communication and after offering the opportunity for stakeholder feedback on the basis of the present Communication, and subject to an impact assessment, the Commission will present further legislative proposals in June to ensure financial stability and the safety and soundness of CCPs that are of systemic relevance for financial markets across the EU and to support the further development of the Capital Markets Union (CMU).