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**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK AND THE
EUROPEAN ECONOMIC AND SOCIAL COMMITTEE**

A path towards a stronger EU clearing system

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A path towards a stronger EU clearing system

1. INTRODUCTION

A safe, robust and competitive clearing ecosystem in the EU is essential for a well-functioning Capital Markets Union (CMU). Central clearing supports trading in capital markets: when trades are cleared centrally, a central counterparty (CCP) interposes itself between the parties to a trade and becomes the buyer to every seller and the seller to every buyer, guaranteeing the performance of the contracts. It can do so thanks to a system of guarantees that it collects from the parties. Through clearing, each party has a single net exposure to the CCP instead of a complex network of bilateral exposures to individual counterparties. In this manner, CCPs increase market transparency and efficiency as well as reduce the risks in financial markets, especially for derivatives. CCPs play a key role in the clearing ecosystem, which includes both entities that participate directly in CCPs (as “clearing members”), such as large banks and investment firms, and entities that participate in CCPs indirectly (i.e. through clearing members), such as investment funds, smaller banks, insurance companies, corporates. If clearing does not function efficiently, financial institutions, companies and investors face more risks and higher costs.

EU rules for clearing and CCPs are set out in the European Market Infrastructure Regulation (EMIR)¹, complemented by the Regulation establishing a framework for the recovery and resolution of CCPs.² EMIR provides a strong framework for risk management and transparency in clearing markets. However, new challenges have arisen.

First, clearing capacity is an important dimension of the CMU: that is why the EU needs a competitive and modern clearing system. The CMU is about building deep and liquid EU capital markets that can serve the needs of EU citizens, businesses and financial institutions. The Commission continues to implement the 2020 CMU Action Plan.³ Alongside this Communication, the Commission is adopting a legislative proposal to make it less burdensome for companies to list and raise capital on public exchanges (the “Listing Act”). The Commission is also putting forward a proposal to harmonise key aspects of corporate insolvency law, tackling one of the most important obstacles to cross-border investments within the EU. However, a genuine CMU needs to rely on competitive market infrastructures. As part of the CMU, the Commission has already proposed a review of the Markets in Financial Instruments Regulation⁴ and of the regulatory framework for central

¹ Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, OJ L 201, 27.7.2012, p. 1.

² Regulation (EU) 2021/23 of the European Parliament and of the Council of 16 December 2020 on a framework for the recovery and resolution of central counterparties, OJ L 22, 22.1.2021, p. 1–102.

³ Commission Communication ‘A Capital Markets Union for people and businesses – New Action Plan’, COM/2020/590 final.

⁴ Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 600/2014 as regards enhancing market data transparency, removing obstacles to the emergence of a

securities depositories.⁵ To strengthen the CMU, the EU also needs to reinforce its domestic clearing capacity.

Second, the EU clearing ecosystem must be **safe and resilient**: EU supervision needs to be enhanced to ensure proper monitoring and control of cross-border risks within the EU coming with increased clearing volumes. To build resilience, the lessons drawn from the **recent developments in energy markets**, with several energy companies facing liquidity issues when using derivatives, need to be taken into account. These developments have illustrated that EMIR has to be enhanced so that the risks to the EU's financial stability continue to be mitigated in light of new challenges. This means building a safe and robust EU clearing ecosystem, which is able to withstand economic shocks. Such an ecosystem which allows a wide range of participants, including energy companies, to hedge their risks efficiently and safely, to better predict margin calls and hence manage their liquidity needs more effectively.

Third, competitive, well-developed and resilient EU CCPs are a pre-condition for the EU's open strategic autonomy. It is crucial that the EU remains open to global financial markets in order to attract investors and support the global competitiveness of European firms. At the same time, following the withdrawal of the United Kingdom from the EU, the vast amounts of euro-denominated contracts cleared at UK CCPs entail risks for the EU financial stability and for the transmission and conduct of the EU's monetary policy. Building robust clearing capacity in the EU reduces the risks stemming from excessive exposures to third-country CCPs.

To achieve this, on 7 December 2022 the Commission has presented legislative proposals amending EMIR and other pieces of legislation to make the EU a more attractive cost-efficient clearing hub and address potential vulnerabilities. The measures will impact both the supply and the demand of clearing services. They will help to expand the range of clearing solutions on offer from EU CCPs and enhance their liquidity, by incentivising more market participants to clear there.

These proposals follow extensive consultations, including with Members of the European Parliament, representatives from the Member States and their authorities, the European Supervisory Authorities (ESAs), the European Systemic Risk Board (ESRB), the European Central Bank (ECB) and the Single Supervisory Mechanism (SSM), as well as a broad range of industry stakeholders.⁶ The impacts of these measures do not depend only on making legislative changes, but also on the engagement and commitment by all actors involved, both public and private. Regulators and policymakers can set the conditions for an enhanced clearing landscape in the EU. But ultimately it is for market participants to take up the opportunities offered by regulation. Public authorities in the EU can also play an important role, leading by example and contributing to a safer, more resilient and competitive clearing ecosystem in the European Union.

consolidated tape, optimising the trading obligations and prohibiting receiving payments for forwarding client orders, COM/2021/727 final.

⁵ Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 909/2014 as regards settlement discipline, cross-border provision of services, supervisory cooperation, provision of banking-type ancillary services and requirements for third-country central securities depositories, COM/2022/120 final.

⁶ In 2021 the Commission steered a working group on the opportunities and challenges of transferring derivatives clearing from the UK to the EU CCPs and in 2022 it held a targeted consultation, as well as meetings with Member States' representatives and with representatives of the European Parliament.

2. A COMPETITIVE AND MODERN EU CLEARING SYSTEM

a. For CCPs

CCPs are catalysts of financial stability and need to be able to respond to developments in the markets dynamically. EMIR established a robust framework for central clearing. But certain areas of the current supervisory framework have proven overly complex. The supervisory approval procedures for launching new clearing services and activities by EU CCPs can be unnecessarily long and burdensome, hindering the launch of new products on the market. Changes in CCP risk models face similar challenges. It should not take years to approve a new product, and model changes need to be swift to reflect changing market and economic circumstances. Delays in approvals increase costs and limit the competitiveness of EU CCPs, reducing the attractiveness of the EU as a place to do business. It is imperative, therefore, to remove these obstacles.

Key Actions: The legislative proposal amending EMIR introduces new procedures the authorities involved in EU CCP supervision should follow to approve new activities or services that EU CCPs wish to offer, as well as changes in risk models. Documents to be provided by CCPs in their applications are standardised and the length of time to obtain approval is reduced to a few weeks. A new, short procedure for launching new activities and services without material changes to the business model of a CCP is also introduced. These reforms will considerably shorten the time it takes CCPs to bring a product to market or make a substantial model change. EU CCPs are encouraged to make the most of potential opportunities offered by a new framework, including by broadening their product range to meet the demand of their clearing members and clients.

b. For financial sector participants

Financial participants using the services of CCPs, e.g. investment funds and insurance companies, should also benefit from reduced costs when using clearing services. Following the post-2008 crisis reforms and the move to centralised clearing, adjustments were also made in the banking framework, enabling banks to benefit from a preferential capital treatment when they clear at an authorised or recognised CCP⁷ rather than engage in bilateral transactions.⁸ This makes sense because CCP clearing reduces counterparty credit risk. These changes to bank prudential rules have not, however, been fully mirrored in other pieces of financial sector legislation. The current rules on counterparty exposure limits for derivative transactions in the UCITS Directive⁹, for example, do not fully reflect the risk-reducing nature of central clearing for investment fund managers. Inconsistencies exist also in the Solvency II framework for insurers.¹⁰

This lack of consistency has become more problematic as EU CCPs have started offering new ways of accessing clearing, which help funds and insurance companies. Under the Solvency

⁷ An authorised CCP is a CCP established in a Member State and authorised under EMIR (Art. 14). A recognised CCP is a third-country CCP recognised by ESMA to provide clearing services to EU clearing members and trading venues in accordance with EMIR (Art. 25).

⁸ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012, OJ L 176, 27.6.2013, p. 379 – 387.

⁹ Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), OJ L 302, 17.11.2009, p. 32 – 96.

¹⁰ Delegated Regulation (EU) 2015/35, OJ L 12, 17.1.2015, p. 1.

II framework, for example, the CCP-related exposures of insurance companies wishing to become direct CCP members can be subject to higher capital requirements than where insurers act as indirect clearing participants. These higher capital requirements are a disincentive to using these new access models. Some EU pension scheme arrangements, which will come under a clearing obligation in June 2023, are starting or have already started using the new access models. The more actors involved in the system, the more liquidity and opportunities are available to transact.

Key actions. In addition to the requirement of an active account at EU CCPs (see section 4), the legislative proposals adopted on 7 December 2022 amend the UCITS Directive and the MMF Regulation¹¹ to better reflect the risk-mitigation role of CCPs authorised in the EU or recognised by ESMA. As regards insurance companies, the Commission intends to address the disadvantageous prudential treatment insurers face if they become a direct clearing member, in the context of the forthcoming revision of the relevant Delegated Regulation.¹²

3. A SAFE AND RESILIENT CLEARING ECOSYSTEM

a. Ensuring robust and joined-up supervision

Developing the EU clearing ecosystem may lead to additional risks within the EU due to increased clearing volumes. For these risks to be properly managed, EU CCPs must be subject to thorough supervision both at the national and the wider EU level. Indeed, given the central role of clearing in the EU financial system, risks stemming from supervisory failures extend beyond national boundaries.

Recent market developments have also confirmed the need for a more holistic risk monitoring and control: CCPs stand in the middle of a complex chain of interdependencies and central clearing is not just the business of CCPs and some large banks, but involves different types of economic actors in different Member States. Recent market developments have highlighted the need for better information on the relationships and interdependencies across the entire clearing chain: even if CCPs are robust, liquidity issues of market participants may result in vulnerabilities which must be identified and addressed.

This means that the EU must reinforce the framework for the authorities to work together effectively on the ground, share knowledge and insights and develop a common supervisory culture from the bottom-up. An ecosystem where the monitoring of clearing chains, which run across Member States and markets, involves EU bodies. This is particularly true for emergency situations¹³, where decisions need to be made with the full picture in mind, in the interest of the EU and Member State economies alike.

These objectives can be achieved by building on the EU's current supervisory system. Supervisory arrangements for CCPs were reformed in 2019: while national CCP supervisors

¹¹ Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds, OJ L 169, 30.6.2017, p. 8 – 45.

¹² In the context of the review of the Solvency II Directive, the Commission concluded that supplementing amendments to Delegated Regulation (EU) 2015/35 will be needed to reach all the objectives of the review (see COM(2021)580). Against this background, the Commission has launched discussions about the possible content of the amendments to Delegated Regulation (EU) 2015/35.

¹³ Emergency situations include, e.g., situations impacting the CCP's soundness or resilience, or developments in financial markets, which may have an adverse effect, e.g., on the stability of the financial system in the Member States where the CCP or one of its clearing members are established (see Art. 24 of the proposed Regulation).

retain final responsibility for the supervision of CCPs established on their territory, the role of ESMA has been made stronger by setting up a CCP Supervisory Committee composed of EU CCP supervisors, three independent members and central banks for certain discussions. The Supervisory Committee supervises systemic third-country CCPs, while for EU CCPs its role remains mostly that of promoting convergence.

Key actions. The Commission legislative proposal further develops and strengthens the EU supervisory framework, including by: i) establishing joint supervisory teams for certain tasks, to set the basis for more cooperative supervision with a wider EU perspective and to develop supervisory knowledge and experience throughout the EU; ii) facilitating the monitoring of cross-border risks to the EU throughout the clearing chain by EU authorities, such as the ESAs, ECB, ESRB and the SSM; and iii) allowing ESMA, through its CCP Supervisory Committee, to co-ordinate common responses to emergency situations on the basis of up-to-date information.

b. A more robust framework for clearing commodity derivatives

Commodity derivatives markets allow firms, including energy producers, suppliers and distributors, to manage risks of volatile prices, and offer longer-term fixed contracts to customers. Over the summer, price spikes and extreme volatility in energy derivative markets have led to liquidity issues for energy companies. These market participants have experienced pressures on liquidity because of higher margin calls linked to rising prices. As part of its package of energy emergency measures, the Commission has proposed, for example, to extend the list of assets that can be posted as collateral at EU CCPs.¹⁴

Nevertheless, beyond the emergency measures, recent market developments have already highlighted targeted areas for structural improvements of the EMIR framework. Indeed, the broader implications of recent market dynamics should be carefully looked at, as also suggested by ESMA in a recent letter to the Commission.¹⁵ Hedging of energy exposures has become more challenging for some participants, as commodity price volatility has increased and CCPs have called more margins. In stress scenarios, margins increase, reflecting the higher risks faced by market participants. In this manner, central clearing increases the need to ensure proper liquidity management by all clearing participants, to meet margin calls. In addition, recent market developments have brought the attention to the way non-financial firms, such as corporates, access CCPs, as the liquidity strains may be greater in case a corporate accesses a CCP directly, without the intermediation of a financial clearing member such as a bank. The EU clearing ecosystem should enable EU firms to hedge their risks efficiently and safely, while at the same time safeguarding financial stability. In this way, central clearing can and will support the EU economy.

¹⁴ Commission Communication 'Energy Emergency - preparing, purchasing and protecting the EU together', COM/2022/553 final.

¹⁵ ESMA's letter to the European Commission of 22 September 2022: <https://www.esma.europa.eu/file/125192/download?token=6iK84Onz>.

Key actions. The legislative proposal amending EMIR enables firms to get a better understanding of their future potential liquidity needs when clearing centrally by requiring margin models to be more transparent for all: it is easier for a firm to plan liquidity needs if it can understand what sort of margin calls it may face, particularly in a situation of stress. EU CCPs already provide tools that simulate the behaviour of margin models. This information should however be passed on through the clearing chain, as the liquidity needs arising from margin calls do not stop at the level of the clearing member, who will therefore be required to clearly explain to their clients how margin calls work and provide simulations under different scenarios. The legislative proposal amending EMIR also strengthens the requirements for participating in a CCP, to avoid that undue risks spill over to other clearing members. If non-financial firms have direct access to a CCP, they must be better equipped to fulfil their obligations. The legislative proposal also takes into account ESMA's recommendations to amend the methodology to determine the clearing threshold, making it easier to implement and more predictable. It also requires ESMA to review and clarify the conditions for a transaction to be considered a hedge and therefore not count towards the clearing threshold.

4. A clearing ecosystem supporting the EU's open strategic autonomy

Clearing is a global business, and EU market players are active at several CCPs around the world. The work in the area of CCP equivalence over the last several years clearly shows the commitment of the EU to an open financial system that supports the international standards and cooperation. The Commission has adopted CCP equivalence decisions for more than 20 jurisdictions, which allowed the EU market to open up to more than 40 third-country CCPs. This means opportunities for third-country CCPs and opportunities for EU market participants, which often accompany European firms to foreign markets.

At the same time, "open strategic autonomy"¹⁶ means that the EU needs to be able to address risks to financial stability that can arise when EU market participants are excessively exposed to third-country entities, as this can be a source of vulnerability. The United Kingdom, in particular, plays a key role as a hub for central clearing: in the first half of 2021, 91% of all euro-denominated interest-rate swaps trades were cleared in the United Kingdom.¹⁷

To mitigate the risks arising from the potential abrupt interruption of access by EU market participants to the UK CCPs following the withdrawal of the United Kingdom from the EU, the Commission adopted temporary equivalence decisions covering the regulatory and supervisory framework for those CCPs.¹⁸ The current temporary equivalence decision covering the framework for CCPs in the United Kingdom expires on 30 June 2025.

At the same time, the Commission has urged EU market participants to reduce excessive exposures to such systemic infrastructures located in a third country, in light of the potential risks in a stress scenario. Indeed, in case of stress, excessive reliance of EU market participants on CCPs established in third countries makes it difficult for EU regulators and

¹⁶ See Commission Communication 'The European economic and financial system: fostering openness, strength and resilience', COM/2021/32 final.

¹⁷ See CEPS 2021, "Setting EU CCP policy - much more than meets the eye".

¹⁸ Commission Implementing Decision (EU) 2018/2031 of 19 December 2018, Commission Implementing Decision (EU) 2019/544 of 3 April 2019, Commission Implementing Decision (EU) 2019/2211 of 19 December 2019, Commission Implementing Decision (EU) 2020/1308 of 21 September 2020 and Commission Implementing Decision (EU) 2022/174 of 8 February 2022.

supervisors to address the financial stability risks for the EU. As noted by ESMA¹⁹, in times of crisis, changes to the eligible collateral, margins or haircuts may negatively impact the sovereign bond markets of one or more Member States, and more broadly EU financial stability. Disruptions in key markets relevant for EU central banks' monetary policies may also hamper the transmission mechanism of those policies. In times of crisis, EU authorities would not be in the driving seat for taking the relevant decisions.

It is important to prepare for high-risk but low-probability events. Increasing clearing capacity in the EU and strengthening the clearing ecosystem will reduce the excessive exposures of EU market participants on third-country CCPs in the medium-term, thus supporting the EU's open strategic autonomy.²⁰

Key actions. The legislative proposal amending EMIR requires market participants subject to a clearing obligation to clear a portion of the products that have been identified by ESMA as of substantial systemic importance through active accounts at EU CCPs.²¹ This will contribute to reduce the financial stability risks posed by excessive exposure to third-country CCPs, as identified by ESMA. To complement this measure, the legislative proposals also amend the Capital Requirements Directive and the Investment Firm Directive to enhance monitoring and treatment of concentration risk that may arise from exposures to CCPs.²²

The Commission is also proposing to simplify the equivalence assessment under EMIR when the risks involved in clearing in a third country are particularly low. Experience has shown that there is room for making the equivalence framework in EMIR more proportionate and to better tailor cooperation with foreign supervisors, based on the different magnitude of risks posed by CCPs in third countries – and without compromising on the need for third countries to have sound rules in place.

5. THE ROLE OF PUBLIC AUTHORITIES

To develop a competitive clearing ecosystem, supervisors, central banks, other authorities and public entities, both at national and EU level, have an important role to play.

Public entities, e.g. public debt management offices, are exempt from the obligation to clear their derivatives at a CCP under EMIR. This is justified to allow these bodies to accomplish their mission in the public interest. Some public entities have chosen over the years to start centrally clearing their contracts on a voluntary basis. Central clearing brings with it greater safeguards in terms of counterparty credit risk, improves markets liquidity and adds transparency. The Commission strongly encourages public authorities in the EU to clear at EU CCPs, should they decide to clear and where the products sought are available. On its part, **the Commission commits to clearing most of its centrally-cleared positions at an EU CCP**, where the products sought are available.

¹⁹ See ESMA report of December 2021: <https://www.esma.europa.eu/press-news/esma-news/esma-publishes-results-its-assessment-systemically-important-uk-central>.

²⁰ See Commissioner McGuinness Statement on the way forward for central clearing: https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_21_5905.

²¹ Interest rate derivatives denominated in euro and Polish zloty, short-term interest rate futures and credit default swaps denominated in euro.

²² The measures will give supervised entities (credit institutions and investment firms) an incentive to reduce excessive concentration risk by, for example, diversifying/scaling back their exposures. To the extent that a competent authority will consider that the actions taken by an entity it supervises are insufficient to reduce that risk, it will be able to impose supervisory measures.

The contribution by national public authorities can be useful in the area of accounting rules. There are some uncertainties around the application of certain national rules in the area of hedge accounting²³ which could in practice discourage transfers of positions from a third-country CCP to an EU CCP. **The Commission invites national authorities to look at national accounting rules and remove or alleviate any obstacles to transferring exposures.**²⁴

Central banks are also important players. The Commission's public consultation in early 2022 highlighted broad support by stakeholders for further advancements in European payment systems, more specifically TARGET2. TARGET2 is a unique payment system, which works on a real-time, gross-settlement basis for its community of participants and is a key infrastructure supporting the euro. A number of market participants, both banks and CCPs, expressed the view that the operating hours of the system are too short, implying that some margins late in a business day are called by EU CCPs in foreign currencies such as the US dollar. According to market participants, this situation presents difficulties both for CCPs, which need to be able to invest US dollars received in the repo market, and for clearing members and clients, which are requested to have the necessary amount of US dollars available to meet the margin calls. This could be a concern particularly in times of stress, when CCPs' margin calls can occur at later hours and are of varying amounts. The Commission wants to avoid that EU market participants depend on foreign currency liquidity to meet margin calls by EU CCPs, in particular in times of stress. **The Commission therefore invites banks and CCPs to engage with the Eurosystem** on these topics and discuss all possible ways of using the system. The Commission trusts that market participants, together with the Eurosystem, will examine the issues raised in the 2022 targeted consultation and find a solution to address them.

Another aspect that was brought to the attention of the Commission is related to central bank access policies for CCPs regarding deposit and liquidity facilities. As shown by a 2018 report of the International Monetary Fund²⁵, the Eurosystem has established access policies for CCPs in general. Due to the multiplicity of such access policies, the IMF made some recommendation to the ECB/Eurosystem to explore potential harmonisation across relevant access policies for CCPs. **The Eurosystem is looking further into the aforementioned issues.** It is noted that the access policies with respect to central bank deposit and liquidity facilities fall within the Eurosystem's mandate and tasks that are performed in line with the principle of independence of central banks.

5. CONCLUSION

The reforms after the 2008 global financial crisis have allowed EU financial markets to face recent market developments from a much more robust position than before 2008. A key piece of these reforms is central clearing. Central clearing is fundamental for trading and for well-developed capital markets. It is fundamental in building the CMU. The experience of the

²³ The objective of hedge accounting is to represent in the financial statements the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss.

²⁴ The Commission stands ready to provide technical support to Member States and their public authorities, under Regulation (EU) 2021/240 of the European Parliament and of the Council of 10 February 2021, to facilitate public authorities' clearing at EU CCPs, in case they decide to clear, and to review the national accounting rules so as to remove or alleviate any obstacles to transferring exposures.

²⁵ IMF Country Report No. 18/226, July 2018:
<https://www.imf.org/~media/Files/Publications/CR/2018/cr18226.ashx> .

current EU framework has nevertheless revealed a number of areas where improvement is needed.

One important aspect is to build a greater clearing capacity in the EU to strengthen our capital markets, provide our firms with more clearing options and ensure that financial stability is preserved, while keeping the EU capital markets open.

The revision of the EU clearing framework will also address issues that have emerged in the clearing of derivatives by energy firms, which are currently facing unprecedented shocks. A strong clearing system allows corporates to hedge their risks efficiently and better predict margin calls. But it is also one in which corporates are well-equipped to participate in central clearing, and are properly supervised when they do.

The measures targeting CCPs and other aspects of the clearing system described above in this Communication will not succeed if taken in isolation, as clearing tends to concentration. They need to be accompanied by clear measures targeting the demand for clearing services and incentivising that demand to flow towards EU CCPs. Greater demand for clearing at EU CCPs will lead to greater liquidity at these CCPs.

Finally, a stronger EU clearing system can play a central role to support the EU's open strategic autonomy. There cannot be open strategic autonomy if the EU does not develop its clearing capacity and address its vulnerabilities. This is also crucial for the EU to play fully its role in the global context, contributing to global financial stability by offering more clearing options.

This package of measures can pave the way for a stronger, safer and more competitive clearing ecosystem in the EU for years to come. In light of the importance of the package and considering the current environment, the Commission supports swift progress by the European Parliament and the Council towards the adoption of the measures and stands ready to facilitate the inter-institutional negotiations. Determined effort by all parties will be of the essence to achieve success.