

Deputy John McGuinness, Chair
Joint Committee on Finance,
Public Expenditure and Reform, and Taoiseach
Leinster House
Dublin 2

30 November 2017

Ref: I 2017/290

Dear Deputy McGuinness,

Re: 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.

Further to the letter of Eoin Hartnett of 9 October 2017 concerning the above, Governor Lane has asked me to reply on his behalf. Accordingly, I am pleased to set out the Central Bank of Ireland's (the Central Bank's) initial assessment of the EU Commission proposal regarding the procedures and authorities involved for the authorisation of central counterparties (CCPs) and requirements for the recognition of third country CCPs ("CCP Supervision").

The Existing Regulatory Framework

The European Market Infrastructure Regulation (EMIR) sets out the current framework governing the supervision of CCPs. It distinguishes between the supervision of EU CCPs and third country CCPs.

EU CCPs

Under EMIR, supervisory colleges oversee EU CCPs. These supervisory colleges are CCP-specific and are composed of representatives from the national competent authority (NCA)¹, the European Securities and Markets Authority (ESMA), relevant members of the European System of Central Banks (ESCB), and other relevant authorities (e.g. supervisors of the largest clearing members, supervisors of certain trading venues and central securities depositories).

While the supervisory colleges consider a number of issues, the home NCA is ultimately responsible for important supervisory decisions such as the extension of the authorisation or the approval of outsourcing and interoperability arrangements.

The Central Bank is a member of the supervisory college for three EU-based CCPs: (i) Eurex, as Irish equities are cleared on its platform; (ii) ATHEXClear and (iii) the Keler CCP, as, in both cases, entities supervised by the Central Bank are significant clearing members of these CCPs.

Third Country CCPs

Under EMIR, third country CCPs are permitted to provide clearing services to EU clearing members or trading venues on the condition that they are recognised by ESMA prior to providing these services.

EMIR only permits ESMA to recognise a third country CCP if it meets the following conditions:

- a) The European Commission has adopted an implementing act that recognises the legal and supervisory arrangements of the third country where the CCP is established as equivalent to EMIR.
- b) The third country CCP is authorised in the relevant third country, and is subject to effective supervision and enforcement ensuring full compliance with the prudential requirements applicable in that third country.
- c) There is a cooperation arrangement in place between the relevant EU NCA(s) and third country supervisors.

¹ The national authority tasked with day-to-day responsibility for the microprudential supervision of the CCP.

- d) The CCP is established or authorised in a third country that is considered as having equivalent systems for anti-money laundering and combating the financing of terrorism to those of the Union.

Under the current third country framework, the Commission has adopted implementing acts recognising the equivalence of the legal and supervisory arrangements of 14 third countries, and (as of September 2017) ESMA has recognised 32 third country CCPs. The Central Bank, in our capacity representing Ireland at ESMA, has a role in approving ESMA's decisions to recognise a third country CCP.

Overview of CCP Supervision Proposals

In June 2017, the Commission proposed an update to the supervisory structure of EU CCPs and for third country CCPs operating in the EU. The Central Bank notes that there are three main elements to the CCP Supervision package: a new regime for EU CCPs; a new regime for third country CCPs; and, an increased role for the 'central bank of issue'² of the relevant currencies that the CCP provides clearing services for.

EU CCPs

The core element of the CCP supervision proposal is to create a central supervisory mechanism for all EU-domiciled CCPs, called the Executive Session, which would be housed in ESMA. It would be composed of:

- (i) permanent members, including an independent Head and two Directors, who would have votes, and a representative of the ECB and the Commission, who would be non-voting; and
- (ii) members specific to each CCP, including a representative of the competent authority

² The 'Central Bank of Issue' may be considered as the central bank which issues the currency in which a financial instrument and/or derivative contract is denominated.

from the Member State where the CCP is established, who shall be voting, and a representative of the relevant central bank(s) of issue, who shall be non-voting.

Third Country CCPs

Under the proposals, third country CCPs would be subject to a sliding scale of additional supervisory requirements by ESMA and relevant central banks of issue, based on object criteria or thresholds. The degree and intensity of EU supervision is intended to be proportionate to, and depend on the risks posed by, third-country CCPs to the EU.

Less systemically important³ third country CCPs (Tier I) would continue to be subject to supervision by their own regulator, as is currently the position under EMIR. Systemically important CCPs (Tier II) would have to comply directly with EMIR and be subject to direct supervision by ESMA (i.e. the CCPs would be unable to rely on their own domestic regulatory regime being deemed equivalent to EMIR).

On top of this, the proposals would give the Commission, subject to input from ESMA and the relevant central banks of issue, the power to adopt an implementing act that would force a third country Tier II CCP to establish within the EU if they wanted to continue to provide clearing services to EU clients (a so-called 'location' requirement). Such action would be taken on the suggestion of ESMA, in agreement with the relevant central banks of issue, on the basis that a CCP may be of such substantial systemic importance that direct compliance with EMIR would not sufficiently ensure the financial stability of the Union.

Role for the Central Banks of Issue

The proposal provides the relevant central bank(s) of issue with non-voting membership of the Executive Session mechanism. It also grants the central bank(s) of issue more substantive oversight of

³ Systemically important is not specifically defined in the proposals; however, the proposal does contain criteria for determining systemically important CCPs, based on the nature, size and complexity of the CCP's business; the effect of the failure of a CCP; the CCP's clearing membership structure; and interconnectedness with the broader financial system.

CCPs in the context of the implementation of monetary policy and/or the promotion of smooth operation of payment systems.

The Motivation for Amendments

One of the overarching reasons for the proposed changes is the expanding role that CCPs are playing in the financial system since the adoption of EMIR. For example, at the end of 2015, about 60% of all over the counter (OTC) interest rate derivatives were centrally cleared. The corresponding figure for the end of 2009 was 36%. Central clearing has similarly gained in importance in the credit derivatives (CDS) market, with the proportion of outstanding CDSs cleared through CCPs increasing steadily since these data were first reported (i.e. 37% at the end of June 2016, which is up from 10% at the end of June 2010).

The Commission has also highlighted other factors that have had a bearing on the need for the proposed changes:

- The increasing concentration of activity in a small number of CCPs, potentially posing systemic risk.
- The expected increase in clearing activity in the future, including from an expansion of mandatory clearing requirements.
- Upcoming regulatory initiatives which will impact the market, e.g. Capital Markets Union (CMU).
- The current third country approach and its overreliance on compliance with home-country regulation, not EMIR.
- The fact that the current supervisory framework does not adequately reflect the role of central banks of issue, and that there is no process for checking ongoing equivalence of third country regimes with EU rules.
- The impact that Brexit may have on the European, and global, clearing landscape. As UK-based CCPs have a large market share of clearing of euro-denominated derivatives.

The Central Bank's Initial Assessment

The Department of Finance represents Ireland in the discussions on the proposals within the European Council. The Central Bank is providing technical assistance to the Department.

There are no Irish-based CCPs. The focus of the Central Bank's analysis has therefore been on the perspective of the users of CCPs, including end-clients and clearing members.

As set out in the Central Bank's response to the public consultation on the operations of the European Supervisory Authorities⁴, central clearing is, we believe, an area that could benefit from direct supervision by ESMA. As such, elements of the Commission's proposal should enhance the microprudential supervisory framework for CCPs providing clearing services in the EU.

The areas of the CCP supervision proposal the Central Bank would like to draw the Committee's attention to are:

- (i) The role of the central bank of issue;
- (ii) The principle of subsidiarity for the supervision of EU CCPs;
- (iii) Consistency between the CCP Supervision proposal and the proposed Regulation on CCP Recovery and Resolution; and
- (iv) The proposed location policy.

The Role of the Central Bank of Issue

The Central Bank – in line with the European Central Bank's (ECB) opinion⁵ on the CCP supervision proposal - is supportive of the proposal to enhance the oversight role of the relevant Central Bank of Issue in the process for the supervision of EU CCPs and the recognition of third country CCPs.

⁴ <https://www.centralbank.ie/docs/default-source/Regulation/how-we-regulate/policy/response-to-european-commission-consultation-on-esas.pdf>

⁵ ECB (2017) Opinion of the European Central Bank on a proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 1095/2010 and Regulation (EU) No 648/2012 with regard to the procedures and authorities involved for the authorisation of central counterparties and the recognition of third country central counterparties (CON/2017/39) https://www.ecb.europa.eu/ecb/legal/pdf/en_con_2017_39_eu_f_sign.pdf

This is because the failure of a CCP could have consequences for the basic tasks of the ECB⁶ as such an event could affect the liquidity positions of euro area credit institutions who act as general clearing members for the CCP, or could impair the functioning of financial markets that are key to the transmission of monetary policy (such as interest rate derivative contracts and repurchase markets).

The Principle of Subsidiarity for the Supervision of EU CCPs

The Central Bank's technical analysis on centralised supervision for EU CCPs is guided by the principle of subsidiarity – which suggests that a central authority should perform only those tasks that cannot be effectively performed at a more local level.

Some CCPs are relevant for the functioning of markets across the EU and their failure would have consequences across the Union's financial system. However, this is not the case for all EU CCPs so there would appear to be a case for differentiating between larger, systemic CCPs (supervised by ESMA) and smaller, less systemic ones (supervised in their home Member State) in the future supervisory architecture.

Consistency between the CCP supervision package and the CCP recovery and resolution package

The CCP Recovery & Resolution proposal operates under the principle that the recovery and resolution of EU CCPs should be a national, rather than EU-wide, responsibility. This proposal was developed prior to the CCP Supervision proposal and, as such, from a technical perspective appears misaligned with the EU-level approach taken in the CCP Supervision proposal.

The Central Bank's strong view, based in particular from our experience in the development of the EU's Banking Union, is that the approach to supervision and recovery & resolution needs to be aligned. EU-level supervision with national resolution would be highly problematic, as it would give to significant misalignments and discontinuities in this important area.

⁶ The definition and implementation of the monetary policy of the Union and the promotion of the smooth operation of payment systems

Location Policy

Much public debate in response to the CCP Supervision proposals has focused on the so-called location requirement. From a technical perspective, there is no precedent for the cross-border transfer of clearing activities on the scale that would be required if, for example, one of the larger third country CCPs currently providing clearing services in the EU were required to transfer that part of its business inside the Union.

Some public authorities, notably the ECB, have expressed concern with having the majority of euro-denominated transactions cleared outside of the EU (or euro area), as the current third country CCP regime set out in EMIR provides EU authorities with limited tools for obtaining information and taking action in the event of a crisis⁷. By requiring a third country CCP to locate within the EU, authorities would have significantly improved access to critical information, as well as direct control over the relevant recovery and resolution tools that are currently being negotiated as part of the proposed Regulation on CCP Recovery & Resolution.

For these reasons, and in line with the ECB, the Central Bank supports the proposed legislative option to require a CCP to provide its services from within the EU.

In the event of the exercise of this option, there is the potential for disruption to the provision of clearing services in the event that a location requirement is enacted. These disruptions, even if only temporary, may lead to disproportionate impacts on the financial systems of smaller Member States. As such, the potential for disruption should be appropriately addressed as part of the final proposals, for example by inserting appropriate transitional provisions in the legislation which would take effect following the exercise of the option.

⁷ Speech by Benoit Coeure, Member of the Executive Board of the ECB, at the Global Financial Markets Association, 20 June 2017 found here: <http://www.ecb.europa.eu/press/key/date/2017/html/ecb.sp170620.en.html>

Application of the proposal following implementation

Your letter also asks for the Central Bank's view on the application of the proposal following implementation. As I am sure you can appreciate, it is difficult to provide a detailed assessment on impacts at this juncture given that the proposal is not yet agreed. Additionally, there is an interdependency in terms of the impact of this proposal with the outcome of the CCP R&R discussions, as well as further amendments to EMIR, under the so-called EMIR REFIT⁸ discussions.

Were the CCP Supervision proposal adopted in full as currently drafted, it would involve a significant change to the microprudential supervisory architecture for CCPs operating in the EU. The impacts will be less directly relevant for Ireland, as there is no CCP presently established in Ireland; however, it is too early to estimate precisely the impact on end-clients and clearing members.

The Central Bank would, of course, be happy to provide a further written update to the Committee upon final agreement of the CCP Supervision proposal.

Conclusion

The Central Bank stands ready to provide the Committee with further technical details as may be required.

Yours sincerely

Gerry Cross
Director, Policy and Risk

⁸ In November 2016, the Commission adopted the [EMIR report](#), which indicated that no fundamental change should be made to the nature of the core requirements of EMIR. On the other hand, the report pointed to the possibility of amending EMIR in some specific areas so as to eliminate disproportionate costs and burdens on certain derivatives counterparties and to simplify rules without compromising the essence of the legislation. The corresponding amendments to EMIR have been titled 'EMIR REFIT'. Further details can be found at https://ec.europa.eu/info/law/better-regulation/initiatives/com-2017-208_en