Clearing made easier and more resilient – but you can't make an omelette without breaking eggs

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Further reform of the rules on market infrastructures under the European Market Infrastructures Regulation (EMIR) aims to bring more clearing (from the UK) to the EU, but once again it does not integrate supervision into the process. EU-based users of central counterparty clearing houses (CCPs) abroad will also be required to have active accounts at EU CCPs.

The proposal addresses the recent upheaval in energy markets by including energy companies in the scope of the proposal. It wants to simplify the approval of new products, make it easier to participate in clearing facilities and facilitate equivalence assessments.

This third set of amendments to the 2012 European Market Infrastructures Regulation (EMIR) was proposed by the European Commission on 7 December 2022 as part of a new capital markets union (CMU) package, also comprising a new listing act and the start of insolvency harmonisation. This will probably be the last set of harmonisation efforts in the capital markets domain (under the von der Leyen Commission), apart from the retail investment strategy, which is expected in the course of the first half of this year.

Bringing clearing onshore is the most politically important objective of this proposal, already made clear when the Commission announced the extension of the equivalence for CCPs with the UK. Today, CCP clearing is highly concentrated in a few financial centres around the globe, with the City of London playing a very important role. 94 % of all euro-denominated interest-rate swaps trades were cleared in the UK in the first half of 2021, for example. This raises financial stability concerns for the Commission, which in the context of the EU's 'strategic autonomy' ambitions, need to be tackled.

Euro-denominated based exposures to foreign CCPs, because of margins calls or haircuts on government debt, posted as collateral, could endanger the stability of the international financial system. Although EMIR 2.2 introduced a structure for EU supervision (by the European Securities and Markets Authority (ESMA)) of systemic third country CCPs, the Commission wants to have more of these transactions take place within the EU.

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A central component of the proposal is the requirement to open 'active' accounts at EU CCPs, or the clearing of certain derivative contracts with an EU-based CCP to achieve the onshoring objective. The Commission argues that this will reduce the financial stability risks posed by excessive exposure to systemic third-country CCPs. As the Commission argues, the cost of maintaining active accounts (i.e. the doubling of accounts) does not outweigh the benefits of better financial stability control.

Moreover, and given that many entities already have accounts within the EU, and apart from some initial administrative costs, there will even be benefits (by bringing more critical mass to the EU), and lower costs in the long term. The problem is that the most important competitors in the derivatives markets (i.e. third-country banks) will not have to maintain active accounts in the EU. They will be able to continue clearing in large clearing centres, unencumbered by this requirement (which will further disadvantage EU banks in these markets). Maintaining active accounts creates operational costs and liquidity challenges, as large EU banks will need to manage two accounts and two sets of margin calls.

Another element of the proposal relates to the recent upheaval in the energy markets, the problems raised by the price volatility and the impact on margins calls on market participants. The Commission proposes to extend the list of assets that can be posted as collateral at EU CCPs, and to ease the predictability of obligations for clearing participants. But whether the proposal facilitates the membership of CCPs for non-financial firms, which was part of the problem, is unclear and remains to be seen. Corporates that want to join a CCP will have to meet robust liquidity and reporting requirements.

Other parts of the proposal can be described as sweeteners or non-objectionable. This is the simplification of the approval process for CCPS' new products and services, the improved transparency of CCPs margin models, the ease of the equivalence assessment procedure, and facilitating participation in CCPs through cost reductions (e.g. insurance companies in their prudential requirement and pension funds as of July 2023 onwards).

The biggest missing element, and a contradiction compared to what the proposal aims to achieve, is more centralised supervision for EU-based CCPs. Bringing more clearing onshore will increase volumes, but as long as supervision remains at national level in the EU for the 13 EU-based CCPs resilience will not necessarily improve. EMIR 2.2 already subjects systemic third-country CCPs to direct oversight by ESMA, without doing the same for EU-based ones.

This current proposal continues to avoid the matter, indicating that it is sufficient to merely increase supervisory cooperation – or the 'spaghetti' of cooperation between EU and national authorities – and co-ordinate common responses in emergency situations – and this for such systemically important entities?

Instead, it would have been better, and consistent, to fully leave supervision with ESMA and build upon the expertise acquired by ESMA's CCP Supervisory Committee. Doing so would avoid unclear supervisory responsibility sharing and facilitate decision-making in periods of stress.

To facilitate central clearing for other entities, the proposal does not only amend EMIR 2.2 but also the Undertakings for Collective Investment in Transferable Securities (UCITS) and the Investment Firms directives (IFD), the Capital Requirements Regulation and Directive (CRR/CRD) and the Money Market Funds (MMFs) regulations. In some of these cases, these amendments are minor, but given the co-decision making process in the European Parliament and Council of the EU, getting through five separate amendments is likely to be complex.

Bottom line, this is a half-baked proposal at best. The active accounts requirement may reduce financial stability concerns with third countries, but creates competitive disadvantages for EU banks. It also avoids the confrontation with the Member States on supervision.

If the EU's aim is to make the European CCP ecosystem more attractive and competitive, then avoiding confrontation is not the answer. It's time to start breaking some eggs.

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