Clearing: EMIR3 and further priorities

1. EMIR 3.0 objectives and implementation

1.1 Current state of clearing in Europe

An industry representative observed that, despite the prolonged periods of market stress due to Covid, the Ukraine war and incidents such as the yen carry trade turbulence during the summer of 2024, taxpayers' money has not been used in recent years and public bailouts could be prevented. This has been a major achievement of the regulatory reform agenda over the past 15 years since the great financial crisis and the G20 Pittsburgh reforms. It is also symbolic of the positive result of the progress made on clearing regulation in particular with EMIR and the CCP recovery and resolution framework in the EU, which have fostered financial stability. The EU has demonstrated strong leadership in the regulation of clearing activities at the global level and can be considered to set the gold standard.

While the need for further efforts around the attractiveness of the EU clearing ecosystem, including with EMIR 3.0, are very much appreciated, it is also important to recognise that the EU has strong clearing capacities and an effective ecosystem in certain areas, for example on exchange-traded derivatives (ETD). Therefore, a targeted approach to those areas where further progress is needed to ensure global competitiveness is important.

Another industry representative observed that there has been limited change in the clearing landscape in continental Europe in recent years in terms of integration and costs. Processes are very efficient for liquid instruments such as long-term interest rate derivatives, but clearing costs are quite high for more illiquid asset classes, such as small and medium caps, particularly for retail investors. Responding to the point on prices, an industry representative stated that clearing prices are competitive at EU CCPs, particularly when considering the financial stability and efficiency gains that can be achieved.

1.2 Key objectives of EMIR 3.0 and implementation timetable

The Chair commented that, although the adoption of the EMIR 3.0 Level 1 text in February 2024 is a major milestone, it is still not formally in force and its publication in the official journal is awaited. There is a mandate for ESMA to deliver a set of 28 regulatory technical standards (RTS) and guidelines for the implementation of EMIR 3.0 between 6 and 18 months after it comes into force. This will require prioritisation. Focus will initially be on the Active Account Requirements (AAR) and streamlining approval procedures for minor extensions of services and risk model changes, before revising requirements for CCPs in a second stage. While there has been much emphasis on the first two items in the debates prior to the adoption of EMIR 3.0, it is the combination of the different measures proposed in EMIR 3.0 that will improve the competitiveness and resilience of the EU clearing ecosystem.

EMIR 3.0 provides ESMA with a stronger coordination role for EU CCPs, in particular in emergency situations, and aims to enhance supervisory convergence between National Competent Authorities (NCAs), with for example the co-chairing with ESMA of the CCP supervisory colleges. The creation of the joint monitoring mechanism that will monitor risks across CCPs is also important from a financial stability perspective. The activities of this new body will add an important element that is currently missing in the supervisory space.

The implementation of EMIR 3.0 will require a collaborative effort from all players in the ecosystem. Industry engagement and preparation will be vital. Preparatory work can begin regarding the elements set out in the Level 1 text. ESMA is aware of the deadline and will issue consultative papers on the RTS as soon as possible, which will provide additional indications of the steps to undertake for implementing EMIR 3.0.

A policymaker explained that the EMIR 3.0 clearing package aims to support competitive and attractive clearing markets in the EU, while ensuring financial stability. The strengthened supervisory framework for EU CCPs will help to better mitigate risks. The package also promotes a reduction of overreliance on UK CCPs and improves the rules for non-financial corporates that clear derivatives. EMIR 3.0 moreover aims to enhance the competitiveness of EU clearing markets with measures including streamlined approval procedures for CCP risk model changes and product extensions deemed to be minor. In addition, the new package will increase the transparency of margin models so that all market participants can better prepare for margin calls, in parallel with work being done at the international level to improve the provision of margin. The focus is now on implementation, where ESMA will play a key role. Two aspects are of particular importance in the short term. First, active account requirements (AAR) must be properly implemented. Second, market participants need to take full advantage of the measures to enhance the competitiveness of EU CCPs.

An official observed that the implementation of EMIR 3.0 is still at an early stage and there is time to ensure that the necessary conditions are in place, including the engagement of all stakeholders. CCPs must recognise that the market is competitive and rapidly evolving and that significant investment in innovation will be necessary to remain competitive and expand into new markets. In terms of supervision, the new mechanisms for enhanced cooperation between ESMA and the national competent authorities (NCAs) including the co-chairmanship of supervisory colleges, as well as the new Joint Monitoring Mechanism, must be efficiently operationalised. They will strengthen collaboration and lead to more uniform supervisory practices.

Another official stated that the RTS will be a key part of the effectiveness of EMIR 3.0. The planned 18-month review will be an important milestone to assess the effectiveness of the measures.

2. EMIR 3.0: key measures

2.1 Active account requirements (AAR)

A policymaker highlighted the conditions for an effective implementation of the AAR, which aim to reduce the EU's excessive reliance on third-country CCPs with the introduction of a requirement for EU market participants to hold an active account at EU CCPs. Market participants need to start preparing for the implementation of the AAR immediately, as accounts with EU CCPs will have to be opened within six months of the entry into force of EMIR 3.0. RTS need to be clear for market participants but also sufficiently ambitious within the boundaries of the Level 1 text with meaningful targets, in order to change the current market dynamics. An appropriate reporting framework is also needed to enable the authorities at national and European level to monitor the functioning of the AAR. ESMA and the Commission will assess the possible need for additional measures based on the observed effectiveness of the AAR.

An industry representative agreed that the implementation of the AAR must start now. Although the negotiations on the AAR have been tough, a balanced outcome has been achieved that reflects the range of different interests. The approach is proportionate, with carve-outs for small entities, global client business and non-euro currencies (except zloty dimension).

An official stated that EMIR 3.0 should help to address the EU's current overreliance on systemic or super-systemic offshore CCPs and the related financial stability risks. However, it will not be possible to assess the effectiveness of the framework until it is fully implemented. Since 2022, the amount of IRS cleared in the UK has increased by 40%, driven by significant changes in interest rates and volatility movements. This was not the expected evolution. In this context, it is important that the EMIR 3.0 Level 2 measures make the framework as effective as possible. It is hoped that the AAR will quickly trigger a significant migration of positions into the EU. This should include not only flows but also holdings, and not only short-term but also long-term positions, which are the most important in terms of risk mitigation. EU CCPs must also become a real back-up in case of disruption of an offshore CCP.

An industry representative considered that although the AAR are a positive development, they are unlikely to significantly change the clearing landscape in continental Europe. The clearing of interest rate swaps (IRS) is likely to remain predominantly located in London. The situation will likely be the same for Euribor futures, which are less systemic and could have been more easily shifted to the continent.

2.2 Streamlining of authorisation procedures

A policymaker stated that the Level 2 RTS on streamlined authorisation procedures need to identify in a clear and predictable way the offers and changes that can be authorised quickly and those that require more extensive procedures due to higher risks. These requirements need to be implemented consistently across the EU. Public and private stakeholders will need to work closely together in the coming months to take advantage of the new opportunities offered by the reformed regulatory framework.

An official emphasised that clarity and consistency will be essential when applying the measures for streamlining the regulatory approval process. CCPs must understand which criteria to apply and what documentation is required. Clearly defined rules will enable faster regulatory approvals and a more efficient release of services in the market.

An industry representative stressed the importance of streamlining approvals to speed up time to market. In the past, there have been concerns that allowing CCPs to launch new products and services and to review risk models more quickly could create new risks, but speeding up these processes is actually in the interest of financial stability, as it is safer to adapt risk models quickly in response to market events.

Another industry representative agreed that the EMIR 3.0 measures to streamline authorisation processes for new products and model changes will be beneficial. Launching new products can currently take up to two to three years in the European market, which is too slow for a fast-moving industry such as clearing. Allowing faster changes to live models or products, without having to restart a lengthy full approval process, could greatly improve market efficiency. Getting real-time feedback from users is also essential for the clearing industry. Some clearing houses already have mechanisms in place to gather input from risk committees composed of representatives of authorities and users. This feedback loop could be extended more widely across the market to accelerate and facilitate product improvements and their adaptation to user needs.

3. Priorities in the clearing space beyond EMIR 3.0

The Chair noted that, beyond the scope of EMIR 3.0, there are further issues to be considered in the clearing area. Some relate to the further improvements needed in terms of competitiveness and integration of EU clearing activities to support the future steps of the CMU initiative. Others relate to the scope and modalities of central clearing activities to further enhance financial stability.

3.1 Enhancing the competitiveness and integration of European clearing activities

An industry representative noted that the objective of enhancing the competitiveness of EU clearing has been mentioned in several recent reports, including the Draghi and Letta reports and the Noyer report on CMU.

Proposed measures include reducing the fragmentation of the clearing landscape in continental Europe and moving towards a unified supervision of central counterparties at EU level. There is political momentum behind these two measures, but discussions on these issues have been going on for a long time. Pragmatic action is needed for progress to be made.

A policymaker considered that a move to more European level supervision will be politically challenging to implement but could have significant implications in the clearing space. A further evolution to consider is the move to T+1 settlement. An assessment of the potential impact on clearing of this change is needed. Shortening the settlement cycle could bring significant benefits in terms of efficiency gains and margin savings, as has been seen in the US, but it is uncertain whether the US experience can be fully replicated in the EU.

A second industry representative emphasised that enhancing the competitiveness and agility of EU CCPs should be the key focus of further measures in the EU clearing area alongside maintaining financial stability. More competitive CCPs will support the strategic autonomy of the EU and its broader competitiveness, including the international role of the euro.

A third industry representative suggested that, beyond strategic autonomy and control over central clearing, the EU should aim for more scalable power in this area. While the EU has led the regulatory agenda on clearing, the focus should now shift to leading the global market by enhancing competitiveness, which requires speed and scale.

Speed is needed to optimise clearing processes and to innovate. CCPs need to be able to adapt quickly to market changes, but the excessive level of detail in regulatory texts and overly prescriptive rules, in particular to promote harmonisation, are a challenge in this respect. This hampers the ability of CCPs to exercise judgement and perform outcome-based analysis. More European-level oversight, with broader reference points than domestic CCPs, should also support innovation in the clearing space.

Scale is also important to increase the attractiveness of the EU clearing market. The EU has a competitive advantage over smaller jurisdictions due to its large population of 450 million people and the potential size of its addressable market. However, a more unified market with common rules and fewer competitors per asset class is needed to attract non-European players. The aim should be the emergence of several European champions to help channel savings from outside the Union into EU investment programmes. For example, Japanese, Australian, and Canadian banks participate in the repo clearing business for Next Generation EU bonds, meaning that these foreign jurisdictions are effectively financing the EU economy. However, not all CCPs in the EU should be treated equally in terms of integration and interoperability measures. The larger, multi-asset, pan-European entities will require different solutions than the more focused entities.

3.2 Digitalisation to enhance post-trading processes

An industry representative stated that technological innovation, notably tokenisation and blockchain solutions combined with the use of central bank digital currencies (CBDC) should help to improve the efficiency of post-trading processes. Efforts are being made by central banks and the industry to experiment with these new technologies, but greater resources must be invested in these developments to avoid lagging behind the significant advances being made in the US and UK. Otherwise business might shift outside continental Europe.

An official observed that the use of digital assets could lead to new post-trading models, the development of which needs to be closely monitored. The digital euro and other CBDCs have an important role to play in this context as settlement assets, in order to promote sound financial innovation and ensure that settlement risk continues to be properly managed.

Another official commented that the use of asset tokenisation and digital assets in the post-trading space is being widely experimented by central banks and industry in Europe, which is at the forefront of these new developments. A challenge however is being able to scale up these experiments in a way that does not complexify post-trading business models and does not create new risks. Achieving this will require the collective effort of the public authorities and the industry.

An industry speaker agreed that safety should remain a priority. Innovation and the implementation of new technology must not impair the ability of CCPs to mitigate risks and prevent contagion. A key element of safe innovation is the full segregation of asset classes, with dedicated resources for each asset class all the way to the default fund. This ensures that any failures in one asset class do not affect others and that the risks posed by each asset class are clearly identified.

3.3 Extending the scope of central clearing and clearing capacity

A policymaker observed that the scope of products to be centrally cleared beyond derivatives is part of ongoing discussions at the international level. Central clearing can improve market functioning, enhance transparency and offer netting opportunities to dealers. Some jurisdictions, such as the US, are imposing clearing mandates for government bonds, while some are reflecting on ways to enhance the clearing of repo transactions, which was one of the Financial Stability Board (FSB) recommendations after the great financial crisis. Repo markets have demonstrated resilience in stress situations, which can make them a source of liquidity for entities needing to meet margin calls.

An official added that CCPs are already considering the clearing of digital and crypto assets, such as futures and options on Bitcoin. Crypto raises a number of challenges, including the limited availability of historical data, high price volatility and a lack of harmonisation of regulatory approaches. This leads to legal and operational risk and could create difficulties in the application of risk management tools.

An industry representative noted that the impact of central clearing should not be viewed in isolation, as it can relieve pressure on the bilateral market. The ever-growing flow of debt issued by European member states is currently intermediated by the same group of banks, which have balance sheet constraints and limited intermediation capacity, leading to an imbalance between supply and demand. Clearing can help to reduce this pressure on banks by bringing the non-banking financial institutions (NBFIs), which are the clients of banks, into repo clearing in a way that allows bank intermediation to consume less balance sheet capacity. There are different membership models available that could address this. This could help to release bank balance sheet capacity to support bilateral markets.

Another industry representative agreed that further reflection is needed on the benefit of central clearing, taking into account the total cost of clearing (non-fee related) for customers compared to the benefits in terms of netting and resilience. EU-based CCPs would typically have significantly higher margin requirements due to regulatory realities, including higher MPOR, APC measures, and CCP recovery and resolution which are not comparable in other jurisdictions. In addition, EU CCPs are obliged to hold a banking license to access central bank facilities, adding Bank Recovery and Resolution Directive (BRRD) requirements. Moreover, key capital standards for Clearing Members and customers differ – where other jurisdictions e.g. deviated from the Basel standards in a different way. The EU should therefore holistically reflect further on how to make EU clearing more attractive from an implicit capital cost perspective, nurturing growth and competitiveness.

3.4 Access to central bank liquidity

An official remarked that CCP access to central bank facilities is an important question that requires further investigation. EMIR 3.0 mandates the European Commission to report to the European Parliament and Council on this topic. Current arrangements vary across central banks and depend on whether CCPs have a banking licence. Access to central bank facilities by all CCPs should be further assessed, taking into account level playing field and financial stability considerations. CCPs should nevertheless continue to manage their own liquidity risk and provide adequate safeguards in terms of risk management.

An industry representative commented that central bank liquidity access has been discussed frequently in recent years. There are currently different approaches to this across jurisdictions that need to be further assessed. Especially the overnight dimension is critical to get right in the EU.

3.5 Data quality

An official noted that a great deal of data is generated under EMIR, but its volume and heterogeneity, due to poor reporting quality, make it difficult to use. Improving the quality of the data is necessary to support risk mitigation and facilitate initiatives such as the transition to T+1 settlement. Currently, many individual players clean up their own data but the process is slow and fragmented. Establishing joint teams with adequate expertise and using AI tools could speed up this process and enhance its reliability. Workshops and knowledge-sharing initiatives should be set up to initiate this process.

The Chair agreed that data is a core issue and that further work is needed on data quality, usability and reporting.