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Panel 3: A changing clearing landscape
Opening statement by the Chair

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Ladies and Gentlemen,

It is a great pleasure for me to introduce the next panel discussion, which is entitled "a changing clearing landscape". I would like to thank the organisers of the event for including such a timely and forward-looking topic on the agenda.

As we can all witness, the landscape in which CCPs operate is continuously evolving. A number of changes are reshaping and remodelling the CCP ecosystem, bringing new opportunities and challenges. Since the financial crisis first started in 2008, CCPs have extended their services across markets, expanded their participant basis through direct or indirect access arrangements, and built increasingly closer interdependencies with other market participants, infrastructures and critical service providers. In short, CCPs became increasingly important at a systemic level for the markets they serve. In parallel, regulatory regimes have been adjusted in jurisdictions around the world and, where needed, also enhanced to ensure that CCPs are adequately supervised and that the systemic risk they may pose to financial stability is mitigated.

Before looking at upcoming changes and the challenges ahead, allow me to retrace two key structural changes that occurred in the European clearing landscape since we met at last year's conference.

1. Recent structural changes

Let me first start with the implementation of the enhanced supervisory regime for CCPs in the European Union, that is commonly known as EMIR 2.2. More specifically, I would like to take a look at the establishment of the CCP Supervisory Committee at ESMA, which I am honoured to chair since December 2020.

ESMA's CCP Supervisory Committee

The CCP Supervisory Committee has been established with a mandate to assess CCP sector risks, to further promote supervisory convergence of EU CCPs, to recognise and monitor third-country CCPs providing services in the Union, and to supervise those third-country CCPs that qualify as systemically important for the financial stability of the Union or of one or more of its Member States.

Supervisory convergence is a key objective to ensure that the requirements in EMIR are applied consistently to EU CCPs and that the supervisory activities of national competent authorities are coordinated to mitigate any emerging risks for financial stability. While the CCP colleges that were established under EMIR ensure a collegial approach to the supervision of individual CCPs, the CCP Supervisory Committee is tasked to further promote a common supervisory culture. This is done by exchanging views and opinions on relevant supervisory decisions and establishing common practices across the EU. A key instrument in this are the peer reviews of national competent authorities' supervisory activities on CCPs. These peer reviews are conducted annually and have proven to be successful in defining bets practices and identifying, where relevant, inconsistencies or divergencies in the application of regulatory requirements. Another essential instrument, and one which has garnered particular attention, are CCP stress tests that are conducted to measure the level of resilience of CCPs against common stress scenarios and to identify issues to follow up, as appropriate, by general regulatory initiatives or individual supervisory actions. Again, this year's exercise, which is to be launched shortly, will build on the experiences gained over the last rounds. The Supervisory Committee is currently reviewing the methodological framework, targeting and refining the stress scenarios to be applied, for instance by combining credit and concentration risk, whilst having a closer look at emerging aspects such as climate risk.

Turning to third country CCPs, the review of EMIR has introduced a two-tier recognition regime, which is taking account of proportionality. Under this regime, CCPs that are considered non-systemically important for the EU (a bit counterintuitively called Tier 1) may provide services in the European Union while complying with the regulatory requirements in their country, provided that the European Commission has adopted an equivalence decision. The CCP Supervisory Committee will continuously monitor developments in the jurisdictions and CCPs concerned and review recognition on a regular basis.

Third-country CCPs that are systemically important to the EU financial system (so-called Tier 2 CCPs) are subject to closer supervisory scrutiny due to their potential critical impact on the resilience of financial markets and its participants across the EU. These Tier 2 CCPs will have to comply directly with the requirements in EMIR on an ongoing basis and are directly supervised by ESMA with respect to such compliance. Where Tier 2 CCPs clear financial instruments in EU currencies, they also have to comply with the requirements set by the relevant EU central banks of issue. All these requirements aim to ensure that, given their systemic importance, the risks that Tier 2 CCPs may pose to the financial stability of the Union (or one or more of its Member States) are identified, understood and adequately mitigated.

Brexit
At this point, let me turn to the second structural change that occurred on this side of the Atlantic: the withdrawal of the United Kingdom from the EU.

In the CCP clearing landscape, from a regulatory perspective, the end of the transition period that ended last 31 December 2020 implied a change of status of the three CCPs established in the UK. Prior to the end of the transition period, these CCPs continued to operate under their authorisation as EU CCPs.

In order to avoid cliff edge effects in the clearing domain after the end of the transition period, and to minimise risks to financial stability, in September 2020 the European Commission adopted a temporary equivalence decision for the UK for the purpose of EMIR which will expire on 30 June 2022. This was immediately followed by ESMA adopting respective decisions on the temporary recognition of the three UK CCPs as third-country CCPs, again limited until 30 June next year. These decisions were adopted under the new EMIR 2.2 regime, and two UK CCPs have been recognised as Tier 2 CCPs: ICE Clear Europe and LCH Limited.

The temporary recognition of the UK CCPs has enabled a smooth migration from the EU CCP regime to the third country CCPs regime. Nevertheless, Brexit resulted in two major systemically important CCPs for the Union operating from outside its jurisdiction. ESMA is now called to assess whether the services provided by these CCPs, or some of them, are of a systemic nature that is too substantial to be safely provided from abroad. This assessment will be performed by the CCP Supervisory Committee by June 2022. It will be conducted under a structured evaluation process in accordance with the mandate in EMIR. The Supervisory Committee will carefully analyse potential risks, dependencies and stability implications that result from the current situation and potential evolutions. According to its mandate, it will also look at costs and benefits that may result from a potential relocation of clearing services. In conducting the evaluation and in order to prepare its proposal, the CCP Supervisory Committee will engage with all relevant stakeholders with a view to having as complete as possible data and information to inform the review of the existing Tier 2 CCPs. We are looking forward to such engagements with several of you.

COVID-19
Finally, let me close this look back at last year with a few words on the Covid-19 pandemic, which has changed our lives in many ways, as can be seen from the format of this conference.

As we heard in the first panel discussion today, in the clearing domain, the short-term, immediate impact of the pandemic at its beginning implied high market volatility that we started referring to as the Covid-19 crisis. In the EU, CCPs' risk models generally performed well during this period. This was to quite some extent due to the anti-procyclicality arrangements adopted by CCPs in compliance with EMIR requirements, which helped minimise margin calls and liquidity pressures on clearing members. The findings of the last ESMA CCP stress test, which considered similar market shocks to the ones occurred during the Covis-19 crisis, did not evidence critical shortcomings for the resilience of EU CCPs.

Going forward, ESMA is committed to supporting international efforts to assess the implications of certain market developments on margins and liquidity and the efficiency of APC tools in this regard, building on our analysis of the effectiveness of EMIR.

Furthermore, during the lockdown and other forms of restrictions to local mobility, the pandemic has had a drastic impact on the way CCPs operate and implement business continuity. Most EU CCPs continued to operate with up to 100% of their staff working from home through remote working arrangements. As other firms (and supervisors), CCPs had to adjust quickly to the new working conditions; the operational resilience of their ICT systems has been key to supporting this new modus operandi. From this perspective, the pandemic will likely leave a more long-term impact on how to conceive business continuity and we will likely follow up on this with a closer scrutiny of operational and ICT risk.

2. Upcoming changes and challenges

Now let me move on to upcoming changes and challenges.

Post-Brexit landscape and market fragmentation

First, let me briefly return to the consequences of Brexit. From the EU perspective, I believe that we have not yet seen the full implications of Brexit for the clearing landscape. In the trading sector, we witnessed the relocation of quite some trading activities from the UK into the EU or elsewhere. In the clearing domain, there have been less pronounced developments, certainly aided by the temporary recognition of UK CCPs. Economies of scale and of scope as well as liquidity and level of services remain key factors in the clearing domain. However, markets continue to evolve, and forces in the building of the Capital Market Union may incentivise an increasing emancipation of EU financial markets. Furthermore, recent experiences with the Covid-19 crisis have also raised questions about the role of critical infrastructure services and the ability of societies and governments to have sufficiently robust controls over the supply of such services. The related discussions are often characterised by buzzwords such as fragmentation or sovereignty, but the complexities of the ecosystem surrounding clearing services do not lend themselves easily to simplistic concepts.

In this constantly evolving context, ESMA, through its CCP Supervisory Committee, will ensure that all CCPs that are critical to the EU financial markets continue to comply with EMIR requirements on an ongoing basis, that risks are understood, identified and mitigated and that CCPs offering clearing services to the EU financial markets do so under a single level playing-field. In pursuing these objectives, ESMA is ready to continue to closely cooperate with the Bank of England to coordinate supervisory objectives and activities for UK CCPs in accordance with the parameters set out under EMIR.

I am looking forward to the panel discussion on the medium/long-term implications of Brexit on the clearing landscape and, what potential equilibria should be reached to balance a multi-facetted interplay of risks, economic incentives, policy objectives and, last but not least, the overarching aim to preserve financial stability.

Technological developments and new products for clearing

Moving now to a very different area of changes and disruptions, namely those that relate to technological developments and financial innovation.

We are witnessing an unprecedented stream of innovative products and services leveraging new technologies such as the application of distributed ledger technologies, digitalisation and automatization. Unlike previous rounds of innovation, these innovations and in particular their combination have the potential to affect the whole value chain for financial instruments. Whilst the initial focus has been on the issuance and settlement of transactions or on new arrangements for tokenised payment services, increasingly the focus is also shifting on the clearing space. Whilst some changes may be incremental such as smart contracts supporting margin calls, others may alter the business case for CCPs entirely through integration of clearing and settlement on single platforms. Furthermore, financial innovation and an increasing focus on sustainable finance are also starting to bring new products suitable for clearing.

CCPs have thus the opportunity, and also the necessity, to review their services under this new paradigm. As we saw CCPs starting clearing derivatives on bitcoins or emissions allowance, we may see in the future CCPs clearing digital currencies. At ESMA we are following these developments with careful attention and will make sure that any authorisation for new services and activities under EMIR is provided only if and where any new risk has been identified and properly managed.

Interdependencies and interconnection between banks and CCPs

Finally, as the last part of my opening statement, I would like to highlight the importance, from a supervisory perspective, of identifying and monitoring interdependencies between CCPs and between CCPs and their clearing members, in order to fully understand the systemic implications of a CCP, the risks to which it is exposed and that it poses itself to financial stability. In particular, the interconnection between banks and CCPs can be a critical channel of systemic risk propagations.

Apart from an increased focus on analysing network interdependencies, stress tests, fire drills and crisis simulation exercises are valuable tools that supervisors may deploy to further their analysis of the interdependencies and the systemic impact of a CCP failure on the ecosystem in which it operates. To this effect, ESMA has included in its CCP stress tests interdependencies mapping exercises and knock-on impact analysis and will continue focussing on this as a matter of priority, including looking more closely at the possibility of system-wide stress tests.

In short, the clearing sector is facing multiple changes that may affect the set-up and design of the way clearing services are provided. However, I am confident that ESMA, through the CCP Supervisory Committee, is well placed to react and accompany those developments through a credible, reliable and proportional supervisory framework.

I would like to close here my opening statement, hoping that it sets a bit the scene for our discussion and by thanking you for your kind attention.