EMIR 2.2 (EMIR REVIEW – CCP'S SUPERVISION)

Updated in February 2023

EMIR, which is the European version of the G20 leaders' commitment made during the 2009 Pittsburgh Summit to enhance transparency on the derivatives market and mitigate the current risk generated by those transactions, has entered into force in August 2012. In accordance with Article 85 of EMIR, the European Commission was requested to review and prepare a general report on EMIR for submission to the European Parliament and the Council. A first step has been the adoption of EMIR Refit (entered into force in June 2019).

Considering the growing part of mandatory and voluntary clearing it has been stated that the failure of a CCP while having a low-probability remains with a potentially extremely high impact on the financial stability. Therefore supervisory arrangements for EU and non EU CCPs should be reviewed. This is the aim of EMIR 2.2. One should keep in mind another brick of the CCPs regulatory landscape, namely the European text on CCPs' recovery and resolution.

EMIR is built on three main pillars: risk mitigation, transparency and Infrastructure. This second part of the EMIR review focuses only on CCPs and amends EMIR accordingly.

Main topics of EMIR 2.2:

1. ENHANCEMENT OF THE CCPS' SUPERVISION

- Improvement of the EMIR Colleges
- Extension of these colleges remit to non EU CCPs
- Creation of a permanent internal ad hoc ESMA committee (the CCP Supervisory Committee)
- Ongoing supervision by ESMA for certain non EU CCPs

2. NON EU (THIRD COUNTRY) CCPS SPECIFICS

- New classification of third country CCPs into Tier 1 / Tier 2, depending on the systemic risk they may pose for the Union. The conditions for a "Tier 2" CCP to be recognised by ESMA will be more stringent
- The EC may even require a "Tier 2" CCP to relocate its activities in the EU, if necessary
- Non EU CCPs (TC CCPs) may be fined by ESMA and on-site inspections may be conducted by ESMA

3. THIRD COUNTRY EQUIVALENCE

- Introduction of a regular monitoring of regulatory and supervisory developments in third countries

1. Overview

a. Key aspects of the Regulation

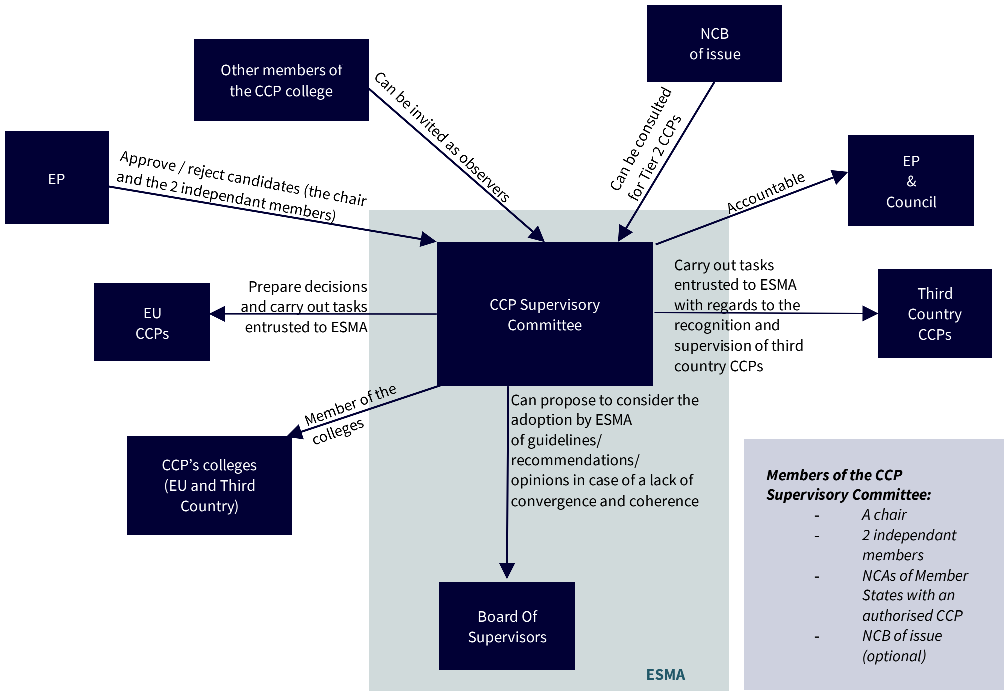
- **The CCP Supervisory Committee**

CCPS' SUPERVISION

With the original EMIR, the supervisory arrangements were mainly under the home-country authority in cooperation with colleges comprising NCAs, ESMA, … In 2016, the European Commission has pointed out the risk for diverging supervisory practices leading to potential arbitrages and thus the need for a greater supervisory convergence. Due to the ESMA's coordination role between NCAs and colleges, it has been decided to address inconsistencies in the supervision of EU and non EU CCPs by creating a permanent internal ESMA committee to handle tasks related to all authorised CCPs and detailed by EMIR 2.2 (preparing certain decisions, carrying out certain tasks which are entrusted to ESMA, …).

The Committee is composed of a Chair, two independant members and representatives of the competent authorities of Member States with an authorised CCP. It can also welcome representatives of Central Banks of issue, as well as members of CCPs colleges. The Chair and the independent members are accountable to the European Parliament and the Council.

The CCP Supervisory Committee will also be able to request the ESMA's Board of Supervisors to consider the need for guidelines, recommendations or opinions to be adopted by ESMA (it is ESMA's role to promote convergence and consistency). In practical terms, this Committee will provide opinions on ESMA's draft technical standards that concern the authorisation and the supervision of CCPs.



- **EU CCPs' colleges**

CCPS' SUPERVISION

EMIR has instituted colleges for EU CCPs. Composed of ESMA representatives, the CCP's Competent Authority, compentent authorities in relation to clearing members of the CCPs as well as in relation to Trading Venues served by the CCP, …., the college is involved in the CCP authorisation and supervisory process.

EMIR 2.2 improves the functioning and the governance of colleges. The participation to colleges is extended to other entities (NCAs or central banks of issue not already members of the college). The Chair (or an independent member) of the CCP Supervisory Committee will also be a member of the colleges, representing ESMA. Members will be entitled to contribute to the agenda-setting of the meetings. Also the role of colleges is strengthened since they will be able to provide opinions on specific cases. Finally, the composition of the colleges becomes public.

- **Process of agreement**

EQUIVALENCE

One should note that the first step remains unchanged. The European Commission will continue to decide if an equivalence exists between EMIR and the legal and supervisory framework of the third country. Without this equivalence, no CCP of this third country can be recognised. ESMA will also continue to provide the Commission with assessments on a potential equivalence.

What EMIR 2.2 introduces is a monitoring of regulatory and supervisory developments in third countries and in relation with the equivalence. ESMA has been empowered to conduct this task. A confidential report shall be provided each year to the Commission and to the third country CCP's college. Should an impact on financial stability be identified then ESMA is required to inform immediately the European Parliament, the Council and the Commission.

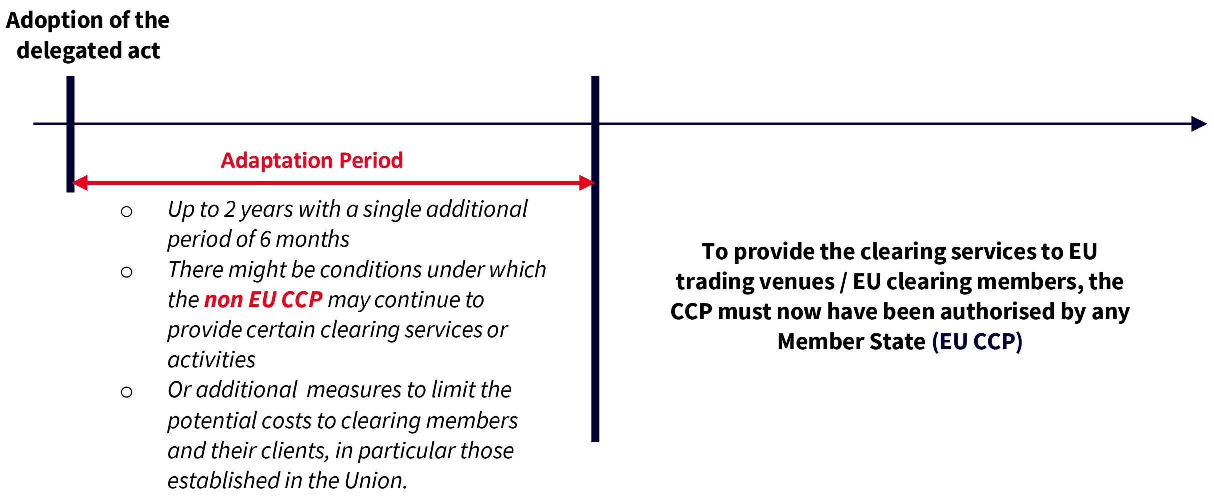
- **Classification (as of January 2021)**

TC CCPs SPECIFICS

With EMIR 2.2, third country CCPs are now qualified Tier 1 or Tier 2 (to be noted this will not apply to EU CCPs). Tier 1 CCPs are those that are not systemically important or likely to become systematically important for the financial stability of the Union or of one or more of its Member States. The others are qualified Tier 2.
The text gives a list of criteria to be taken into account to determine if a CCP is Tier 1 or Tier 2 (nature, size and complexity of the CCP's business in the Union, the effect that the failure of or a disruption to the CCP would have on financial markets, financial institutions, financial stability of the Union, ..).

A Tier 2 CCP (or part of its clearing activities) may be of such substantial systemic importance that it could not be recognized to provide certain clearing services or activities. It is up to ESMA to undertake the analysis, after consultation of the European Systemic Risk Board (ESRB) and in agreement with the central banks of issue and to present its recommendation to the Commission on the basis of a fully reasoned assessment.

Following the ESMA assessment, the Commission will then have to adopt an implementing act confirming that the CCP should not be recognized to provide certain clearing services or activities. This adoption is clearly considered as a "measure of last resort" by EMIR 2.2.



- **Recognition**

TC CCPS SPECIFICS

In case of a Tier 2 CCP, additional conditions to those set in the original EMIR should be fulfilled by the CCP in order to be recognized by ESMA. Practically Tier 2 CCPs shall comply at the moment of their recognition and on an ongoing basis with parts of EMIR (capital requirements, CCPs requirements, interoperability arrangements).Where the requirements are related to margins, liquidity risk, collateral, central bank money or interoperability ESMA shall consult the central bank of issue.

For the Tier 1 the EMIR set of conditions still applies.

The conditions for a review of the recognition by ESMA of a non EU CCP have changed. It shall now be conducted by ESMA when informed of any CCP's intention to extend or reduce the range of its activities and services in the Union and in any case at least every five years. The review encompasses the CCP qualification (Tier 1 / Tier 2).

The new recognition process will start alongside the classification. For CCPs already recognized the review of the recognition should be undertaken within 18 months after the entry into force of the related delegated act.

- **Tier 2 CCP**

CCPS' SUPERVISION
TC CCPS SPECIFICS

With regards to Tier 2 CCPs, ESMA is responsible for the supervision, on an ongoing basis, of the compliance of those CCPs with the conditions specific to Tier 2 CCPs as well as certain EMIR requirements (margins, liquidity risk, settlement – central bank money, …).

- **Third Country CCPs' colleges (should be established by April 2021)**

CCPS' SUPERVISION
TC CCPS SPECIFICS

EMIR 2.2 extends the principle of CCP college to non European CCPs. For CCPs recognised by ESMA before the 1st January 2020, colleges should be in place within 4 months after the entry into force of the related delegated act (January 2021).

b. Others aspects

- **Powers given to ESMA**

TC CCPS SPECIFICS
CCPS' SUPERVISION

EMIR 2.2 allows ESMA to request for information to all recognised non EU CCPs. ESMA may also conduct general investigations and on site inspections where the third country CCP is qualified Tier 2.

- **Fines**

TC CCPS SPECIFICS
CCPS' SUPERVISION

ESMA will be able to impose periodic penalty payments to third-country CCPs or to impose fines on both Tier 1 and Tier 2 CCPs.

- **Fees**

TC CCPS SPECIFICS

Non EU CCPs will be charged fees by ESMA with regards to their recognition but also after, on an annual basis.

c. Progress update and way forward:

- **Next steps**

The regulation has entered into force on the 2nd of January 2020. However measures related to non EU CCPs did not apply before 2021 and the entry into force of the related delegated acts; Therefore ESMA was requested to provide the European Commission with several Draft RTS by the 2nd January 2021 on different topics.

The Commission has adopted on the 1st of September 2020 the delegated act as regards changes to the composition, functioning and management of colleges for central counterparties.

The below level 2 texts have been published in the EU Official Journal on the 21st of September 2020:

- Draft delegated act on criteria for tiering

- Draft delegated act on Comparable Compliance
- Draft delegated act fees for Third-Country CCPs

On the 21st of January: release of Guidelines on written agreements between members of the CCP college

On the 6th of May 2021, publication in the EU OJ of the Delegated Regulation supplementing EMIR, as amended by EMIR 2.2, with regard to rules of procedure for penalties imposed on third-country central counterparties (CCPs) or related third parties by ESMA

On the 12th of July 2021, ESMA issued its methodology for assessing TC CCPs. ESMA has built on the 7 indicators listed in article 25(c) of the level 1 as well as the costs, benefits and consequences of a non recognition. ESMA has retained among others the costs and the needed time in case of transfer/relocation of positions, the consequences of breaking netting sets, impact on competitive position of EU actors, impact on the supervision EU may conduct on TC CCPs, …

d. EMIR 2.2 and Brexit:

- **Equivalence**

On 21 September 2020, the European Commission published a temporary decision (valid from 1 January 2021 to 30 June 2022) on equivalence between Union and UK regulations on the regulatory framework applicable to CCPs. The Commission recalls, however, that it based its decision on the current state of regulation in the UK and that it is in a position to revoke equivalence at any time.

In its communiqué of the 10 November 2021, the European Commission (EC) specified its intentions in the case of the British CCPs. As recalled in the letter, the objective is to not jeopardize the financial stability either in the short term (by abruptly banning access to UK CCPs and thus forcing the relocation of contracts) or in the medium term (due to excessive dependence on CCPs based in the UK). The transfer of the clearing of derivatives within the Union has been the subject of work carried out by various European institutions (the EC, the ECB, ...). They revealed the existence of preconditions, whether in terms of attractiveness, clearing offer of by European CCPs or supervision. As a result, the date of 30 June 2022, marking the end of temporary recognition/equivalence, became hardly tenable. The EC therefore announced that an extension of the “temporary” period would be proposed in early 2022. Discussions on the medium term will have to continue along two lines: building an attractive European offer and providing the Union with an ad hoc supervision framework. Moreover, the cessation of temporary recognition/equivalence should only take place once the supervision system has been reviewed.

On 8 February 2022, the EC officially announced the extension of its temporary equivalence. It now runs until June 30, 2025 three years longer than the previous date. The EC wanted to continue its reflections on the future of central clearing with two objectives in mind: to have an attractive European offer and to have an ad hoc supervisory framework. Therefore the EC launched a rapid consultation. Although EMIR 2.2 covers all types of cleared products, it is clear the consultation focused primarily on OTC derivatives. Different angles are explored along the questions; for example: access to CCPs for entities subject to the clearing obligation, the end of the exemption for PSA, the incentive for public entities to use a CCP even though they are permanently exempted, the extension of the clearing obligation to new products, prudential requirements, the reduction of dependence on third country CCPs deemed systemic … The EC’s objective was to make proposals in the second half of 2022 (done end of 2022).

- **Recognition**

Taking advantage of the publication of the delegated acts on third country CCPs, ESMA has recognised, on the 28th of September 2020, 3 UK CCPs: LME Clear Limited as Tier 1 CCP, ICE Clear Limited and LCH Limited as Tier 2 CCPs. Like the equivalence given by the Commission, these recognitions, which will come into effect on 1 January 2021, are only temporary (they were to end on 30 June 2022).
ESMA intended to use these 18 months to analyse in detail the systemic importance of these CCPs and in particular the provision of clearing services without being located in the Union.

On the 16th of September 2021, several trade associations have written to the EC asking the latter to grant an extension to the current equivalence decision or a non-time-limited equivalence decision and to inform the industry as soon as possible and no later than 3 months before the current end date.

On 17 December 2021, ESMA has issued its conclusions on the two UK CCPs considered Tier 2 (namely LCTH Ltd and ICE Clear Ltd). Based on its assessment methodology , the European regulator has identified different scenarios that could impact financial stability in Europe. These include: the clearing offer on IRS in Euros and Polish Zlotys (LCH Ltd) and the clearing offers of CDS and STIR when they relate to Euro (ICE Clear Ltd). However, ESMA considers that the cost and consequences of a derecognition would be disproportionate in comparison with the benefits for the Union. For this reason, ESMA preferred measures aimed at limiting risks rather than questioning the recognition given to these CCPs.

In the wake of the European Commission, ESMA has (on the 25th of March) postponed the end of the temporary recognition granted to 3 CCPs (ICE Clear Europe Ltd, LCH Ltd and LME Clear Ltd) as of 30 June 2025, thus aligning with the legislative timetable.

NEW! 31st October 2022: ESMA announced it will withdraw the recognition decisions of 6 Indian CCPs (effective on the 30th of April 2023).

e. Other announced equivalences:

9/06/2022 South Africa, India, Chile, Indonesia, Malaysia

23/06/2022 China and Israel

f. Review of EMIR (Refit and 2.2):

NEW! The review process continues with the publication by the EC on the 7th of december 2022 of a proposal. This draft is part of a set of measures to further develop the EU's Capital Markets Union (CMU). As regards clearing, it aims making EU clearing services more attractive and resilient (in particular in the aftermath of the Brexit).

2. Reference text(s)

- Final text (2019/2099)
- Criteria for tiering (2020/1303)
- Comparable compliance (2020/1304)
- UE/UK temporary equivalence
- UK CCPs temporary recognition
- ESMA methodology for assessing TC CCPs
- Trade associations letter (September 2021)
- EC November 2021 communiqué
- ESMA valuation for LCH and ICE Clear
- ESMA methodology for peer reviews (CCPs)
- New extension of the UK CCPs' equivalence
- EC consultation on the clearing framework in the Union
- 2022 EC Review proposal

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