Response from the Swedish Ministry of Finance to the targeted consultation on the review of the central clearing framework in the EU

Thank you for the opportunity to submit comments to the consultation on the review of the central clearing framework in the EU. EU CCPs have an important role to play in the global financial infrastructure and several important CCPs operate within the single market today. While we welcome the Commission’s work that aims to ensure that financial stability concerns related to central clearing are appropriately addressed and that the attractiveness and competitiveness of EU CCPs are ensured, the establishment of CCP recovery and resolution framework as well as the new supervisory structure under EMIR 2.2 are already important recent reforms in this regard. As a general remark, we therefore question larger changes to these relatively new rules at this stage and that the necessity of any changes has been clearly demonstrated. We are also at a general level concerned that certain measures in the consultation could enhance risks and costs to EU financial markets. Finally, we question the relevance and justification behind questions in the consultation relating to supervision of EU CCPs.

As critical infrastructure in the financial system, CCPs inherently pose financial stability risks. EU CCPs are subject to harmonized crisis management rules and procedures, which may increase predictability and control in a crisis situation compared to CCPs located in third countries. At the same time, a shift of central clearing from certain third country CCPs could result in a more fragmented clearing market, which could increase overall risk exposures and raise costs for clearing for EU participants. This is particularly true for smaller currencies such as SEK, where it may be difficult to achieve enough critical mass and diversified participation, e.g., regarding IRD clearing, in several CCPs. With more fragmentation, risks in crisis situations could even be enhanced as the number of potential participants willing and able to contribute to a default process would be smaller at each CCP. It is therefore crucial that measures to promote a shift of central clearing to the EU27 with the aim to increase predictability and control in a crisis situation, are fully justified and applied in a sound and balanced way to avoid negative effects on financial stability as well as excessive cost impacts for EU participants. That being said, we are not opposed to looking at ways to enhance clearing within the EU if such a development is voluntary and market led. Should the Commission decide to propose regulatory measures to require clearing within the EU, such requirements should only apply to clearing services that have been determined by ESMA as being of substantial systemic importance.

The derivatives market is global in its nature, with global institutions and participants, and global supervisory and crisis management principles relying on international cooperation between relevant authorities. Experience from policies that have attempted to force location of central clearing have resulted in fragmentation and higher costs for those local markets. As highlighted in the consultation’s question on a level playing field, such an approach risks creating dual liquidity pools to the detriment of EU participants.

The aim of EMIR 2.2 was to strengthen the regulatory and supervisory framework for systemically important third country CCPs, having in mind the exit of the UK from the single market. The review significantly strengthened the equivalence regime and gave the EU and national competent authorities and central banks enhanced supervisory and oversight powers vis-à-vis systemically important CCPs in third countries. Such CCPs are now for example subject to the same prudential requirements as EU CCPs and under direct supervision of ESMA. EMIR 2.2 has only been operational for little more than two years. We would therefore welcome a more in-depth explanation for how the strengthened third country framework under EMIR 2.2 is insufficient to mitigate these risks. If the main issue regards a lack of predictability and control in the case of crisis management, looking at CCP recovery and resolution frameworks in Tier 2 CCP jurisdictions, including EU authorities’ involvement, could be one area to investigate. In this regard, we are open to discuss measures to address vulnerabilities highlighted by Esma in its report under Article 25(2c) of Emir.

While we welcome the Commission’s intention to consider ways to enhance the attractiveness of clearing within the EU, several of the identified measures seem to go in the opposite direction, which risks increasing costs or otherwise put EU participants at a disadvantage. We believe that capital requirements should be risk-based. We are therefore sceptical to introducing requirements that are not motivated by the existence and identification of a specific risk. We are furthermore concerned that it may be a departure from Basel principles. It is important to remember that the integrity of global principles for capital requirements are dependent on global adherence. Moreover, there is no assurance that the introduction of a specific capital requirement would result in clearing being shifted to the EU instead of other non-EU jurisdictions, e.g., to Tier 1 CCPs where EU authorities and central banks have less supervisory and oversight powers. We are also doubtful to build further on the FRANDT-principles in EMIR 2.2 article 4(3a) by demanding that all clients be offered to clear at EU CCPs. To some extent, the FRANDT-principles already in their current form constitute price regulation, thereby infringing on the freedom of contract. Currently, we do not see the need to expand the product or institution scope of the clearing obligation. We are not in favour of exposure reduction targets as it goes against the principle of having a market led approach.

There are however some topics in the consultation that could merit further analysis. Requiring active accounts at EU CCPs could perhaps be an area to investigate, but we must be wary of the cost impact for (especially smaller) EU participants. Any measures would however have to be preceded by a thorough impact analysis and cautiously calibrated with proportionality in mind. For some institutions, an active account requirement could in practice imply a location requirement as clearing memberships in two CCPs could be economically unsustainable. At the same time, it would be positive if clients who would prefer to clear within the EU but do not have that option today get the possibility to do so. We also understand that the approval processes for CCP:s expansion of product offerings have been criticised and may inter alia disincentivize improvements to risk models and put EU CCPs at a competitive disadvantage. We welcome further analysis of these potential problems and, if relevant, policy remedies.

Sweden has previously supported exempting contracts resulting from post-trade risk reduction measures from the clearing obligation. We believe this measure is worthwhile to consider, as it may contribute to a reduction in overall risk exposures (although it may not contribute to increased clearing at EU CCPs). Looking at ways to enhance liquidity and attractiveness of EU CCPs through segregated default funds could also be worthwhile areas to consider. The PSA-exemption can also be valuable to investigate. Many PSAs are ready for an obligation and clear today. A removal of the PSA-exemption must be preceded by thorough analysis of the consequences for the firms in question (particularly smaller firms) and, in turn, the impact on future pensions, as increased costs ultimately will be paid by the PSA investors. When it comes to hedge accounting rules, we are open to explore this issue.

Responsibility for supervision and crisis management cannot be split

When it comes to questions regarding a stronger role for EU supervision of EU CCPs, we have two fundamental objections. Firstly, we question how the topic as such is relevant to a work stream dedicated to enhancing the attractiveness and competitiveness of central clearing in the EU. Secondly, the supervisory framework for EU CCPs was recently revised in EMIR 2.2. As Sweden underlined during the EMIR 2.2 negotiations, an important principle for us is that responsibility for supervision and crisis management go hand in hand. Before revising the newly adopted supervisory arrangements, we would be interested in an analysis of why and how the current framework is flawed. The current supervisory framework involves a multitude of relevant authorities such as national competent authorities, central banks and ESMA – both through the colleges and in the dedicated ESMA committees. ESMA:s new structures, with a CCP supervisory committee and CCP policy committee, and enhanced involvement in national supervisory work, has in our view strengthened its ability to productively work with national supervisory authorities to improve supervisory convergence and the quality of CCP supervision in the EU. To summarize, it is in general unclear to us why this topic is being revisited so soon after the EMIR 2.2 reform and how it relates to the overall goal of increasing central clearing in the EU.