

Supporting the Eurozone reforms and the international role of the Euro

We at Deutsche Börse Group (DBG) have warmly welcomed the Political Guidelines by the new European Commission and notably its goal to establish the EU27 as a competitive and prospering economic area supported by financial markets built on principles of stability, transparency and fairness. This vision becomes even more urgent considering the current Covid-19 crisis and the enormous efforts that will be necessary for a sustainable recovery and for rebuilding the European economy.

A robust trading and post-trading system, combined with sound policies to ensure fair and orderly markets, is essential under business as usual but especially relied upon when markets are experiencing abrupt market moves. The outbreak of COVID-19 has particularly shown again the need for fair and orderly transparent markets given the ‘flight to quality’– illustrated by the increase in trading volumes on lit exchanges vs. the drop in off-exchange volumes and gains in market shares for lit continuous trading at the expense of auction trading, Systematic Internalisers (SIs) as well as OTC trading.

Consequently, the EU27’s current political reflections on key initiatives such as supporting the international role of the Euro should be seen as an integral part of the European ambitions to fully support operational, well-functioning and stable financial markets given their key function to provide access to financing for companies and to investment for investors based on a robust and transparent price formation process.

Following the aspiration to establish independent and globally competitive structures that support the growth contribution capacity of capital markets and make the EU more attractive for foreign investment, we consider the European Commission’s initiative to strengthen the international role of the Euro to be a significant contribution.

Strengthening the international role of the single currency may be done through different paths: **(1) directly, by increasing the trust and attractiveness of the currency itself; and (2) indirectly, by supporting products and services denominated in Euro as well as the Eurozone’s financial ecosystem.**

(1) Eurozone reforms to increase the trust and attractiveness of the currency

We agree with the European Commission’s assessment that increasing trust in the bloc’s leading currency will require reforming the Eurozone with regard to the Economic and Monetary Union, completing the Banking Union, as well as bringing the Capital Markets Union (CMU) to life.

Against this background, the European Commission’s recent proposal of the recovery plan “Next Generation EU” with its focus on issuing joint debt in euro is a very promising step. It would further deepen EU integration and solidarity among Member States thereby backing the EU institutions and increasing the trust in the euro by investors. In addition, this has also the advantage of offering new safe-haven assets denominated in euro.

Moreover, the creation of a Euro Area Treasury, combining both the political and fiscal leg of a currency, would help building sufficient trust in our common currency, while also facilitating consistent implementation of new EU financial regulation, administration over current economic governance, and the optimization of the development of the euro area in cooperation with all Member States.

The EU will also have to develop a more profound and holistic vision to fully reap the benefits of a fully-fledged CMU. Against this background, we welcome in particular the recently published Recommendations of the European Commission’s CMU High-Level Forum. Their proposed 17 clusters of measures with a focus on the financing of business, market infrastructure, individual investors’ engagement and obstacles to cross-border investment are an important step to deliver upon the CMU’s objectives and to maintain the EU as one of the top financial centres of the world.

(2) Support euro-denominated products and strengthen the EU's financial ecosystem

Boosting the use of the euro in key strategic sectors will make a significant contribution to making the EU more resilient to shocks and more attractive for investments, especially due to capital markets' ability to act as a buffer against systemic shocks and strengthen private sector risk-sharing.

With the right regulatory incentives set in a "fit-for-purpose" framework, market-led solutions can make a critical key contribution by providing for a virtual symbiosis between stability and growth enhancement:

Enhance oversight over key Euro markets: While the quality of the CSDR and the (i)CSD model have helped pave the way for a well-functioning, truly global and harmonised international securities marketplace, a strong euro starts with appropriate supervision and enforcement over systemically relevant Financial Market Infrastructures (FMIs) and a Central Bank which is able to properly fulfil its monetary policy mandate. EMIR CCP Supervision has significantly enhanced the framework towards third country Central Counterparties (CCPs) in the interest of the protection of taxpayers, financial stability and monetary policy conduct. This is supported by the market-led initiative for clearing euro business within the EU27 to cater for the transition into a healthier, more balanced market environment.

In terms of next steps, a speedy and full implementation of EMIR CCP Supervision level 2 measures would help to manage market expectations, ahead of the end of the transition period for the UK leaving the EU. In addition, ensuring that the Euro Area's well-functioning and liquid Exchange-Traded Derivatives (ETDs) are not shifted to off-shore markets via forced open access provisions is key to ensure the stability of the single currency.

Boost euro-denominated trading in key strategic sectors, notably commodity derivatives: we have identified three areas – each at a different level of development – which should be closely monitored and promoted, both for their potential of achieving the EU energy and climate objectives and their potential to become global commodities and hence to promote the Euro as a denominating currency: liquefied natural gas (LNG), hydrogen and emission allowances.

The global energy system needs to fundamentally transform towards carbon-neutral energy sources over the next decades to meet the long-term goals set in the Paris Agreement. Hydrogen might become a new global commodity with the potential of being denominated in Euro. Therefore, the European Commission should continue its work as outlined in the EU strategy for hydrogen.

Further, in recent years, the market for LNG has grown significantly. Because of its growing infrastructure and virtual trading hubs, Europe will become more important for the price formation in the global natural gas market. LNG will stimulate trading in Europe and strengthen local markets and indices, leading to a further decline in the oil indexation of natural gas contracts. That development in itself has helped to improve the role of the Euro as the trading of natural gas contracts in continental Europe is mainly in Euro. As the European market is large enough, here is the potential for a European LNG index – related to the TTF hub – denominated in Euro.

As outlined by the Commission's political guidelines 2019-2024, the EU Emission Trading Scheme (ETS) as the world's leading carbon trading scheme offers great potential to expand the Euro's role in commodity trading: Governments worldwide are increasingly rolling out ETS taking the EU ETS as a role model. And there is potential for a further integrated global emission allowance market. To continue supporting the ETS and trading of carbon denominated in Euro, the EU could consider expanding it to other sectors such as transport and construction.

For euro-denominated commodity markets to emerge and grow, we welcome the European Commission's recognition of the commodity markets framework as a priority for the upcoming MiFID II/MiFIR review, as well as ESMA recent efforts in this respect. A focus of the position limits regime on most liquid, "critical", benchmark contracts and a better tailored pre-trade transparency regime, allowing for more market participants to hedge their risk in euro and thereby promote the growth and

competitiveness of European commodity derivatives contracts. Thus, more proportionate and efficient regimes would contribute significantly to the objective to strengthen the competitiveness of commodity derivatives markets in context of the international role of the Euro.

Reduce intra-EU fragmentation for euro-denominated shares: in order to support companies' interest in getting listed on EU exchanges, issuing euro-denominated shares and trading EU products, we should build on the success stories of our capital markets and avoid any detrimental effects to the European ecosystem. Europe needs to facilitate market access, especially for small and medium enterprises, and promote deep and liquid secondary markets, which allow for a transparent price discovery process and improve cost/capital efficiencies for investors.

Equity markets and re-equitization are essential elements of the recovery and resilience strategies in relation to Covid-19 – given their role as safe havens during times of market stress. Further, they are also decisive for the implementation of the EU's Green Deal and to make Europe fit for the digital age, given that mobilization of enormous financial resources will be necessary to cope with these challenges and to fully satisfy the European Commission's ambitions.

Against this background, more than two years after the start of MiFID II/MiFIR, the new equity trading landscape in the EU raises serious questions on the quality of the price formation process as well as on the level of transparency as trading is highly fragmented across multiple trading venues which are subject to uneven regulatory rules. In order to reduce fragmentation and increase overall transparency it is critical to simplify the EU's equity market structure and limit dark trading as part of the upcoming MiFID II/MiFIR Review - incentivizing trading on lit venues and thereby enhancing the transparent price formation process.

In addition, access to capital markets, especially for SMEs, should be facilitated by creating an ecosystem that takes into account the specific needs of these enterprises and is not based on a "one size fits all" regulation. Removing regulatory barriers that discourage companies from public listing is key to achieving an innovative and competitive EU. To this effect, measures resulting in cross-border friction losses and structural obstacles for companies should be targeted, such as: cumbersome withholding tax procedures, different insolvency procedures and rising costs of access to market-based finance for companies.

Promote transition to robust, more economically sound euro-denominated Risk-Free Rates (RFRs): Products based on Euro rates have an impact on real economy and the proper conduct of monetary policy. The IBOR reform is hence the biggest change in the Eurozone's financial markets since the introduction of the Euro, as trillions worth of financial contracts will have to be moved.

A key area of the market plumbing is the readiness of CCPs and exchanges to offer and clear products that meet market participants' needs for the new euro-denominated rates. DBG is committed to help the market smoothly transition to the new RFRs and build up liquidity – especially in light of the economic fallout of the Covid-19 crisis. We are hence working together with other EU CCPs on the euro discounting switch in July 2020 to ensure that all aspects of the transition from EONIA to €STR are properly implemented.

Because Euribor is expected to continue well into the 2020s, the EU might want to consider observing how the IBOR transition from other jurisdictional term RFRs (e.g. USD/GBP LIBOR) plays out in their respective currency regions, mirroring the positive aspects of the transition plans and help build liquidity in derivatives based on the new rates within the EU. The development of a reliable term rate for €STR is decisive for strengthening the resilience of the financial system.

Develop a solid framework for a digital euro: Strengthening the international role of the euro is also about seizing transformative developments such as digitization. The global financial and monetary system is changing in the digital age. We believe that a digital euro designed by the ECB in cooperation with the national central banks based on a solid regulatory framework for digital assets can be considered as a prerequisite for a EU digital financial industry capable of developing and offering new services based on new technologies, positioning the EU as a global pioneer. Therefore, DBG welcomes

the ECB's announcement to further assess a potential design for a Central Bank Digital Currency, guaranteeing the Union proper monetary policy conduct and control over the Eurozone's joint currency, and providing consumers and the industry with efficient and safe payment systems.

Promote innovation in the FX space: Any policy measure with a view to strengthen the role of the Euro in FX markets should consider market specifics and needs to set appropriate requirements and incentives for market participants and financial market infrastructure providers encouraging them to provide liquidity.

Against this background, we believe that further consideration of the global dimensions and peculiarities of spot FX markets, which have been subject to significant abuse in the recent past, and an assessment of the impact of their inclusion into the regime of the Market Abuse Regulation (MAR) should be carried out as part of the upcoming review of MAR. A more consistent approach to spot FX regulatory provisions and clear binding sanctions regime as provided by MAR would increase the effectiveness of the existing regime and cater for a level playing field. This would further contribute to overall reliability of FX spot markets and facilitate the provision of liquidity – also with a view to strengthen the role of the Euro.

Due to the markets' characteristics, global FX markets remain very dealer-centric off-shore markets. Though recent targeted regulatory intervention has accelerated industry moves from the non-cleared to a cleared OTC FX environment – be it non-cleared margin rules for non-deliverable forwards or regulatory capital costs due to Basel III. Against this background, it remains important to move forward with the final two implementation phases of the uncleared margin rules for non-centrally cleared derivatives.

Finally, market led initiatives, which support both disclosed and anonymous OTC FX transactions across a combination of regulated and OTC trading paradigms, could serve as a blueprint for the next generation FX market, where market participants are able to make an informed choice of the product and model for the trade they need to do, using OTC bilateral activity or exchange-traded or OTC cleared FX products.