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FSbriefing

EMIR 2.2: Third country CCPs

Background

In 2012, the EU adopted the European Market Infrastructure Regulation (*EMIR*) to address globally agreed standards aimed at reducing systemic risk connected with extensive derivatives trading. A significant part of the regime relates to the requirement to clear certain standardised over-the-counter (*OTC*) derivatives contracts through central counterparties (*CCPs*), with may be EU authorised CCPs or certain recognised third country CCPs.

EMIR is currently the subject of extensive review, with amendments being proposed in a number of areas. This briefing focuses on the proposals relating to third country CCPs.

On 13 June 2017, the European Commission (*Commission*) proposed amendments aimed at enhancing the supervision of third country CCPs, as well as making the supervision of EU CCPs more coherent (*EMIR 2.2*).[1]

The European Parliament's (*Parliament*) Economic and Monetary Affairs Committee (*ECON*) voted in favour of the Commission's proposal on 16 May 2018, subject to a number of amendments, and published a report showing its suggested changes on 25 May 2018.[2]

The Council of the EU (*Council*) published what is expected to be the final version of its presidency compromise proposal on the third country CCP provisions of EMIR 2.2 on 26 June 2018.[3] The objective of the Council has been to finalise negotiations on third country aspects under the Bulgarian Presidency, while the Austrian Presidency during its six-month term (running to 31 December 2018) will focus on EU CCP supervision, with the aim of reaching a general approach within the Council on the whole of EMIR 2.2 by the end of 2018.

The third country CCP regime will be subject to substantive change in a number of areas, including in respect of the process and conditions for recognition, which will be based on the systemic importance of the third country CCP, ongoing compliance, supervision and enforcement, regular review of recognised CCPs and cooperation with third country authorities. Under one of the more controversial provisions, it is possible that certain substantially systemically important third country CCPs would be required to relocate to the EU in order to continue to provide services to EU clearing members, although a

1 https://eur-lex.europa.eu/resource.html?uri=cellar:80b1cafa-50fe-11e7-a5ca-01aa75ed71a1.0001.02/DOC_1&format=PDF

2 http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A8-2018-0190+0+DOC+PDF+V0//EN

3 http://data.consilium.europa.eu/doc/document/ST-10499-2018-INIT/en/pdf

The UK leaving the EU is considered to have a significant impact on the regulation and supervision of clearing in Europe.

number of safeguards have been suggested by the Council and Parliament which may make such an outcome less likely. Changes have also been suggested in order to strengthen the oversight and input of other institutions, including relevant central banks.

The proposals have faced criticism in terms of their impact on markets and market participants and the potential for jurisdictional overreach of EU supervision and enforcement, which may not be easily accepted by third country authorities. The effects may be most keenly felt by US CCPs and UK CCPs, which will be third country CCPs post-Brexit.

Three-way negotiations (*trilogues*) between Parliament, the Council and the Commission on the final shape of EMIR 2.2 will follow. Currently, the expectation is that trilogues will start under the Romanian Presidency in January 2019 and close by the end of Q1 2019.

The rationale behind EMIR 2.2

The Commission's EMIR 2.2 proposal followed an assessment of EMIR carried out between 2015 and 2016 and the publication of a first set of proposed amendments in May 2017 aimed at introducing simpler and more proportionate rules on OTC derivatives.

Central clearing has expanded considerably since the adoption of EMIR in 2012. When announcing EMIR 2.2, the Commission emphasised the growing significance of CCPs and pointed to their systemic importance in the financial sector and the associated concentration of credit risk.

In addition, it is clear that the UK leaving the EU is considered to have a significant impact on the regulation and supervision of clearing in Europe and the proposal was drafted with that very much in mind.

A number of concerns were seen as relevant to the need for new requirements:

- the operation of EMIR's current equivalence and recognition regime had revealed shortcomings with regard to ongoing supervision. ESMA faced difficulties in accessing information, conducting on-site inspections and sharing information with EU regulators, supervisors and central banks. As a result, the Commission noted there was a risk that third country CCP practices or adjustments to risk management models could go undetected or unaddressed, which may have important financial stability implications for the EU;
- the potential for misalignments between supervisory and central bank objectives was considered more complex in the context of third country CCPs where non-EU authorities are involved; and
- third country changes to CCP rules or regulatory frameworks could impact regulatory or supervisory outcomes negatively, leading to an un-level playing field between EU and third country CCPs and creating room for regulatory or supervisory arbitrage. The EU would not be notified of such changes automatically and may therefore not be able to take appropriate measures.

Brexit is seen as exacerbating these concerns. A substantial volume of euro-denominated derivatives transactions (and other transactions subject to the EU clearing obligation) is cleared through UK CCPs. As a result, when the UK exits the EU, there will be a distinct shift in the proportion of transactions cleared in CCPs outside the EU's jurisdiction, which is considered to bring about a number of challenges for the safeguarding of EU financial stability.

Changing the CCP equivalence regime

The basic position under EMIR enabling a third country CCP to provide clearing services to clearing members or trading venues established in the EU where that CCP is recognised

by the European Securities and Markets Authority (*ESMA*) will not change under EMIR 2.2.

Recognition depends on an equivalence determination having been made in respect of the relevant third country concluding that the relevant legal and supervisory framework fulfils certain requirements under EMIR for the purpose of enabling recognition of CCPs established in that country.

However, the Commission's proposal provides that an equivalence determination may be subjected to conditions beyond those provided for currently pursuant to EMIR. In particular, the Commission suggests that the "Commission may adopt a delegated act [...] to further specify the criteria" to be used in the equivalence assessment.

In addition, the proposal tasks ESMA with the monitoring of regulatory and supervisory developments in third countries that have been deemed equivalent. Any development that may impact EU financial stability, or the stability of a Member State, must be notified to the Commission confidentially and without delay.

The Parliament has suggested that in addition ESMA should inform the Parliament and the Council of any developments, while the Council has stated that the members of a proposed third country CCP college should be informed.

ESMA will be required to submit an annual confidential report to the Commission in respect of each of the equivalent third countries, which the Council suggests should be provided to the third country CCP college members too.

ESMA should evaluate the degree of systemic risk posed by the CCP when considering the application for recognition.

A two-tier system for third country CCPs

To alleviate concerns relating to third country CCPs clearing financial instruments relevant to EU financial stability, the Commission's proposal aims to make the process to recognise and supervise them more rigorous for those CCPs that are considered to be of key systemic importance for the EU.

As not all CCPs will be of equal systemic importance, the Commission suggests that ESMA should evaluate the degree of systemic risk posed by the CCP when considering the application for recognition. To achieve this, a distinction is made between lower risk CCPs and CCPs that are, or will be, systemically important for the EU or one or more Member States.

The proposal introduces a "two tier" system for classifying third-country CCPs:

- Tier 1 – non-systemically important CCPs: these will continue to be able to operate under the existing EMIR equivalence framework; and
- Tier 2 – systemically important CCPs: these will be subject to new and stricter conditions governing their operation.

In addition, it is possible that certain CCPs would be considered of such systemic importance that the new conditions would not mitigate the potential risks sufficiently, in which case the Commission may decide that such CCPs can provide services in the EU only if they establish themselves in the EU. This is considered further below.

Criteria for establishing whether a CCP is systemically important

According to the Commission's proposal, ESMA will determine whether a CPP is systemically important or likely to become systemically important for the financial stability of the EU, or for one or more of its Member States, by taking into account a number of criteria to be contained in new Article 25(2a) of EMIR.

Criteria for establishing whether a CCP is systemically important:

- nature, size and complexity of the CCP's business, including value in aggregate terms and in each EU currency of transactions cleared, or the aggregate exposure of the CCP to its counterparties;
- effect of failure of, or disruption to, the CCP on financial markets, financial institutions or the broader financial system, or on the financial stability of the EU or a Member State;
- clearing membership structure; and
- the CCP's relationship, interdependencies or interactions with other financial market infrastructures, other financial institutions and the broader financial system.

The Commission would adopt a Delegated Act to specify the criteria further.

These criteria are likely to be subject to a number of amendments during the trilogue negotiations. In particular, both Parliament and the Council have suggested a number of additions to this Article.

Firstly, Parliament has suggested that ESMA's determination should be made after consulting the central banks of issue of the most relevant EU currencies of the financial instruments cleared or to be cleared by the CCP, while the Council proposes consulting the European Systemic Risk Board (*ESRB*) and the central banks of issue.

Secondly, the Commission's first criteria would be expanded significantly by Parliament's suggestions by referring to the business of the CCP both inside and outside the EU, to the extent the latter is likely to affect the overall complexity of the CCP. The exposure of the CCP would need to be considered in respect of its clearing members in the EU and, to the extent possible, to their clients and indirect clients established in the EU, including where any of those members or clients are global systemically important institutions (*G-SIIs*) or other systemically important institutions. The Council has echoed this approach in broad terms, apart from the reference to G-SIIs which is missing from its proposal. According to the Parliament's report, the risk profile of the CCP should be considered, including in terms of legal, operational, business and cyber risks.

Thirdly, in respect of clearing membership structure, the Parliament proposal specifies that the structure of the CCP's clearing members' network of clients and indirect clients should be considered where they can be identified, in particular the proportion of its clearing members and their clients and indirect clients established in the EU.

Fourthly, both Parliament and the Council consider that the Commission's final criterion above should be considered to the extent that those interactions are likely to affect the financial system of the EU or of a Member State.

Fifthly, the Council has added as a further criterion the availability of alternative clearing services in the respective EU currency to clearing members, their clients and indirect clients established in the EU.

Finally, the Parliament has proposed as an additional criterion the immediate and medium-term effect that the failure of or disruption to the CCP would have on the liquidity of the markets served or on the monetary policy implementation of the central banks of issue.

If ESMA determines that a third country CCP applying for recognition is a Tier 2 CCP on the basis of these criteria, then that CCP can be recognised and allowed to provide clearing services in the EU only if it meets further conditions for Tier 2 CCPs set out below, which the Commission considers necessary to reflect the additional financial stability concerns that arise.

CCPs that have been recognised under the current regime will continue to be recognised as Tier 1 CCPs until ESMA determines whether such CCPs are Tier 1 or Tier 2.

Additional conditions for Tier 2 CCPs

The Commission has proposed certain additional requirements that must be fulfilled when a third country CCP is categorised as Tier 2 in order for it to be recognised. These are proposed to be inserted as new EMIR Article 25(2b) and include the following:

Commission condition 1 for Tier 2 CCPs:

Ongoing compliance with the requirements in Article 16 and in Titles IV and V of EMIR, while allowing ESMA to take account of the extent to which compliance is satisfied by compliance with comparable third country rules (see section on comparable compliance below).

These provisions relate to capital requirements, organisational requirements, conduct of business, margin requirements, default fund, financial resources, liquidity risk controls, collateral requirements, investments, default procedures, stress tests, settlement and interoperability arrangements.

The Council has suggested that ESMA should consult the central banks of issue with regard to compliance with Articles 41 (Margin requirements), 44 (Liquidity risk controls), 46 (Collateral requirements), 50 (Settlement) and 54 (Approval of interoperability arrangements).

Commission condition 2 for Tier 2 CCPs:

Confirmation from relevant central banks of issue that the CCP complies with any additional requirements set by those banks in the carrying out of their monetary policy tasks.

This condition is likely to be subject to change during the trilogues, as both Parliament and the Council have suggested a number of amendments, including:

- Parliament requiring that that the CCP complies, or has put in place appropriate measures to comply, on an ongoing basis with the requirements.
- specifying a list of conditions that central banks are able impose:
  - reporting to the central bank of relevant information;
  - commitment to fully and duly cooperate with the central bank's assessment of the CCP's resilience to adverse market developments or conditions;
  - opening of an overnight deposit account in accordance with relevant access criteria and requirements;
  - in exceptional situations, the application of requirements, within the competences of the central bank and relating to liquidity risk controls, settlement arrangements, margins, collateral or interoperability arrangements, in order to address systemic liquidity risk affecting the transmission of monetary policy or the smooth functioning of payment systems. According to Parliament's amendments, these must be consistent with the requirements in Article 16 and Titles IV and V of EMIR. The Council provides that they may include enhancements to liquidity risk management, such as an increase in the liquidity buffer, an increase in the frequency of intraday margin collections, and limits to cross-currency exposures, or specific modalities for depositing cash with the central bank and settling payments in the currency of the central bank with a view to preserving the financial soundness and safety of CCPs and the financial stability of the EU or one of its Member States and to promoting consistency with the requirements of EMIR. Such requirements can be imposed for a maximum of six months, but may be extended for a further period not exceeding six months if the exceptional situation persists.

Parliament has suggested further that a central bank must provide to the CCP and to ESMA a duly justified and reasoned explanation of its decision to impose requirements based on the relevance of the decision for monetary policy tasks.

The Council has proposed that before imposing or extending these requirements, the central bank must inform ESMA, the other relevant central banks of issue and the members of the third country CCP college, providing an explanation of how the requirements preserve the soundness and financial safety of the CCPs and the financial stability of the EU or one of its Member States. The central bank should justify the necessity and proportionality of the requirements in order to ensure transmission of monetary policy or the smooth functioning of payment systems. In addition, ESMA would be required to submit an opinion to the central bank on the effects of the requirements on the soundness and financial safety of the CCP, while other relevant central banks may also submit an opinion.

Where any of the requirements are imposed after recognition has been granted, the CCP would, according to Parliament's amendments, be required to comply immediately.

Pursuant to the Council amendments, such requirements would be considered a condition for recognition and the central banks of issue should provide ESMA with written confirmation within 90 working days that the CCP complies with the requirements, in the absence of which ESMA may consider them fulfilled.

Parliament has suggested that a central bank may propose additional requirements to the Commission and that the Commission may then adopt a Delegated Act adding the requirements or adopt a prolongation of requirements imposed in exceptional circumstances (as referred to above).

Commission condition 3 for Tier 2 CCPs:

Agreement of CCP to provide ESMA within 72 hours with all relevant information and to enable on-site inspections, as well as a legal opinion confirming that the consent is valid and enforceable under relevant applicable laws.

This requirement is intended to enable ESMA to exercise its new supervisory powers. The Parliament suggests extending the 72 hour period to 10 working days.

Commission condition 4 for Tier 2 CCPs:

The CCP should have all the necessary procedures and measures to be able to comply with the first and third condition above.

The section on comparable compliance below would, however, be relevant to this and may enable the CCP to rely on compliance with its home country rules and regulations instead.

Commission condition 5 for Tier 2 CCPs:

The Commission has not adopted an Implementing Act prohibiting the CCP from being recognised.

Parliament has suggested adding as a further condition for Tier 2 CCPs that cooperation agreements have been established.

Comparable compliance

The Commission has noted that the new conditions for Tier 2 CCPs should be applied in a proportionate manner and that therefore third country CCPs should be able to continue to rely on the rules and requirements in their own country if they are comparable with EU requirements.

This "comparable compliance" regime, which will be set out in new Article 25a of EMIR, is intended to reflect a system similar to that applied in the US and relies on a procedure whereby the CCP can submit a "reasoned request" to ESMA to compare EMIR's requirements in Article 16 and Titles IV and V with those of the relevant third country. This request would provide the

factual basis for a finding of comparability and the reasons why compliance with the third country requirements would satisfy EMIR requirements. The Commission would need to adopt a Delegated Act specifying the minimum elements to be assessed and the modalities and conditions for the assessment in order to ensure that it reflects the regulatory objectives of EMIR, as well as EU interests more broadly.

In its report, Parliament has added that ESMA should carry out the assessment taking into account the provisions of the Implementing Act adopted in accordance with Article 25(6) of EMIR (i.e. an Implementing Act determining third country equivalence in respect of the requirements in Title IV of EMIR, that the CCP is subject to effective supervision and enforcement and that the third country provides an equivalent system for recognition of CCPs). Where, as a result of the assessment, ESMA concludes that compliance with the EMIR requirements is satisfied by compliance with comparable third country rules, it must take that conclusion into account for the purposes of the new condition requiring Tier 2 CCPs to comply with the requirements in Article 16 and in Titles IV and V of EMIR.

As a result, where the regimes are comparable, in effect ESMA may waive the application of corresponding EMIR provisions, which would limit the impact of any dual application of EU and third country requirements.

Certain CCPs could be considered of such systemic importance that the new conditions for Tier 2 CCPs would not be considered sufficient.

Third country CCPs of substantial systemic importance

It is possible under the new regime that certain CCPs could be considered of such systemic importance that the new conditions for Tier 2 CCPs outlined above would not be considered sufficient to ensure the financial stability of the EU or its Member States.

In new Article 25(2c) of EMIR, the Commission has proposed that ESMA may in such circumstances, in agreement with relevant central banks, conclude that the CCP should not be recognised and recommend the same to the Commission. On this basis, the Commission may adopt an Implementing Act stating that the CCP may provide clearing services in the EU only after it has been granted authorisation in accordance with Article 14 of EMIR, which would require it to be established in an EU Member State.

This provision is particularly controversial due to the potential for the required migration of euro denominated clearing, for which London is currently the favoured location. Many industry participants are arguing that this would be a mistake and that the proposals underestimate the market fragmentation and potential turmoil that may be caused as a result, as well as the increased costs and reduced efficiencies clearing members may face.

The relocation requirement has been subject to extensive discussion and it is likely that the provision will be amended substantially during the course of the trilogues. In their reports, both Parliament and the Council have proposed a number of changes, including:

- enabling ESMA to identify specific clearing services or activities that it considers shall be provided only to clearing members and trading venues established in the EU by a CCP authorised in accordance with Article 14 of EMIR;
- Parliament has suggested limiting the agreement of central banks to those of the most relevant EU currencies cleared or to be cleared by the third country CCP, while the Council has proposed consulting the ESRB and the central banks of all EU currencies of the financial instruments cleared or to be cleared by the CCP on aspects relating to the currency they issue;
- the Council has proposed that ESMA's assessment must be accompanied by an explanation that compliance with the conditions does not address the financial stability risk for the EU or for one of its Member States sufficiently and a quantitative technical assessment of the costs, benefits and consequences of a decision not to recognise the CCP;
- Parliament has provided that ESMA's recommendation should be accompanied by an analysis of:
    - the criteria considered by ESMA when determining whether the CCP is systemically important;

- the characteristics of the clearing services provided by the CCP, in particular the liquidity and physical settlement requirements associated with the provision of services, and the related likelihood of the CCP needing central bank liquidity assistance in case of severe stress;

- the presence of viable potential substitutes for the provision of the clearing services to clearing members, their clients and indirect clients established in the EU;

- the existence and nature of liquidity support mechanisms available to the CCP in its home country and any other risk mitigating arrangements;

- potential consequences of including outstanding contracts held at the CCP within the scope of the Delegated Act;

- potential consequences, in terms of costs and benefits, of the necessity for the CCP to apply for authorisation in the EU for the CCP's clearing members and their clients and indirect clients established in the EU; the CCP's linked and interoperable financial market infrastructures; the financial stability of the EU or of one or more of its Member States, including whether systemic risk will be reduced as a result of the necessity for the CCP to apply for authorisation in the EU;

- on the basis of ESMA's recommendation and assessment, Parliament provides that the Commission may adopt an act prohibiting the CCP from being recognised, which should specify that some or all services provided by that CCP can be provided only to clearing members and trading venues established in the EU by a CCP authorised in accordance with Article 14 of EMIR, where applicable after an adaptation period; and

- the Council has provided that the Commission may adopt an Implementing Act specifying that, following an adaptation period, the third country CCP must not provide some or all of its clearing services to clearing members and trading venues established in the EU unless it is authorised in accordance with Article 14 of EMIR. The adaptation period would not exceed two years, although it could be extended once by an additional six months. The Commission would specify the conditions under which the CCP may be temporarily recognised during the adaptation period and any measures taken during that period to limit costs to clearing members and their clients (in particular those in the EU). Parliament suggested similar changes with regard to the possibility of an appropriate adaptation period (with no time limit specified), conditions for temporary recognition and measures to be taken during the adaptation period. In specifying the services and adaptation period, the Council has stated that the Commission must consider the characteristics of the services and their substitutability, whether outstanding cleared transactions should be included within the scope of the act (based on legal and economic consequences) and the potential cost implications to clearing members and their clients.

Such a determination would depend on the significance of the third country CCP's activities for the EU as a whole and for Member States' financial stability. Assuming that a number of the additional provisions suggested by the Council and Parliament above are accepted, the process would need to be undertaken based on a thorough analysis of financial stability and risks, as well as costs, benefits and other consequences.

A review should take place at least every two years.

Reviewing the recognition of third country CCPs

Currently EMIR provides for ESMA to review the recognition of a third country CCP where the CCP has extended the range of its activities and services in the EU. The Commission proposes to update current Article 25(5) by adding that a review should in any case take place at least every two years. Provisions relating to the withdrawal of recognition have been moved to new Articles 25m and 25n (see withdrawal of recognition below).

The Council has suggested adding to this that where, following a review, ESMA determines that a CCP that has been recognised as Tier 1 should be recognised as a Tier 2, it will set an appropriate adaptation period (not exceeding 18 months) within which the CCP must comply

with the Tier 2 conditions. Where justified by exceptional circumstances and implications for EU clearing members, ESMA would be able to extend the adaptation period by a period up to an additional 6 months if it has received a reasoned request to do so from the CCP or a competent authority responsible for supervision of the clearing members.

Whilst agreeing with the concept of regular reviews, the Parliament amendments suggest that they should only be conducted at least every two years where the CCP clears an amount of financial instruments denominated in EU currencies exceeding certain thresholds that would be set out in regulatory technical standards. For other CCPs, Parliament has proposed that reviews take place at least every five years.

Parliament goes on to suggest that ESMA may determine that:

- a Tier 1 CCP has become significant, or likely to become significant, for the financial stability of the EU or one or more of its Member States, and shall therefore be reclassified as Tier 2. ESMA must determine an appropriate adaptation period (not exceeding 12 months) by the end of which the CCP must comply with the Tier 2 conditions, but this period could be extended by a maximum of 6 months where justified by exceptional circumstances and the specific needs of EU clearing members;
- a Tier 2 CCP is no longer significant, or likely to become significant, for the financial stability of the EU or for one or more of its Member States, and shall therefore be reclassified as Tier 1; and
- the significance of the CCP has remained unchanged and its classification shall therefore remain unchanged.

The Commission has proposed new responsibilities for ESMA to exercise ongoing supervision over recognised Tier 1 and Tier 2 CCPs.

Enhanced supervision

The Commission considers that EMIR's equivalence and recognition regime for the supervision of third country CCPs has certain shortcomings. Currently ESMA does not supervise third country CCPs actively, but defers to the CCP's home supervisor to undertake the day-to-day supervision of that CCP. However, under EMIR 2.2 the Commission has proposed new responsibilities for ESMA to exercise ongoing supervision over recognised Tier 1 and Tier 2 CCPs (Article 25b).

The enhancement of ESMA's powers is intended to address current difficulties in accessing information from CCPs, conducting inspections and sharing information with EU regulators, supervisors and central banks. The amendments are envisioned to minimise the risk that a CCP's practices or adjustments to risk management models go unnoticed and to address possible misalignments between supervisory and central bank objectives. In addition, they seek to lessen the risk that changes to third country CCP rules or regulatory frameworks could affect the EU's regulatory or supervisory position negatively.

ESMA will be responsible for carrying out supervision on an ongoing basis of the compliance by recognised Tier 2 CCPs with the requirements in Article 16 and Titles IV and V of EMIR. Tier 2 CCPs will need to provide confirmation to ESMA on at least on an annual basis that the Tier 2 conditions continue to be fulfilled.

In addition, relevant central banks must notify ESMA immediately if they consider that a Tier 2 CCP no longer complies with central bank requirements.

Parliament has suggested adding to this that where ESMA receives a notification from a central bank, or where a Tier 2 CCP fails to provide ESMA with the confirmation of compliance, the CCP would be considered as no longer meeting the Tier 2 conditions, thereby invoking the procedure for withdrawal of recognition.

The Commission proposal provides that ESMA would need to prepare and submit draft decisions to the relevant central bank of issue before adopting any decision pursuant to Articles 41 (Margin requirements), 44 (Liquidity risk controls), 46 (Collateral requirements), 50 (Settlement) and 54 (Approval of interoperability arrangements) of EMIR. ESMA would need the consent of the relevant central bank to any aspect of those decisions relating to the carrying out of monetary policy tasks, but this would be deemed given unless the central bank proposes amendments or objects to the decision. If a central bank proposes amendments, ESMA would

be able to adopt the decision only as amended. In circumstances where a central bank objects to the decision, ESMA would not be able to adopt it.

Parliament has proposed its own substantial amendments to this provision. In particular, it suggests removing the ability of central banks to essentially veto a decision. Instead, a CCP Supervisory Committee would need to consult relevant central banks on aspects of the decision that relate to the currencies they issue and the Committee must make every effort to comply with amendments proposed as a result. However, where the Committee does not reflect proposed amendments, it must inform the central bank of its reasons giving an explanation for any significant deviations. These amendments are mirrored broadly in provisions suggested by the Council.

Additionally, the Commission has proposed that ESMA would need to carry out assessments of the resilience of recognised third country CCPs to adverse market developments. The Council has suggested that the central banks of issue may contribute to these assessments, while Parliament has added that this should be in cooperation with third country authorities, central banks of issue and the ESRB, and that it should include at least financial, operational and cyber risks whilst ensuring consistency with assessments conducted of EU CCPs.

A number of additional provisions have been set out the Commission's proposals to strengthen the monitoring and enforcement of ongoing compliance by third county CCPs with EMIR requirements. These include the following:

- a request or a decision by ESMA may require a third country CCP and related third parties to whom the CCP has outsourced operational functions to provide all necessary information to allow ESMA to carry out its duties under EMIR. Lawyers may supply information on behalf of a client, but the client would remain fully responsible if the information is incomplete, incorrect or misleading (Article 25c);

- a decision by ESMA may require a Tier 2 CCP to submit to general investigations (Article 25d), which would empower ESMA to:

    - examine records, data, procedures and any other material relevant to the execution of its tasks;

    - take or obtain certified copies of or extracts from records, data, procedures and other material;

    - summon and ask Tier 2 CCPs or their representatives or staff for oral or written explanations and to record the answers;

    - interview any other natural or legal person who consents to be interviewed; and

    - request records of telephone and data traffic;

- a decision by ESMA may require a Tier 2 CCP to submit to on-site inspections (Article 25e). ESMA should give notice of its intention to carry out an inspection to the third country authorities, which may participate in the inspection. However, the CCP may not be informed in advance if the proper conduct and efficiency of the inspection so requires. Relevant central banks will be invited to participate too. Inspections can be conducted provided that the relevant third-country authority has confirmed that it does not object to those inspections;

- procedural rules, including rights of defence, in the event of serious indications of infringements by third country CCPs (Articles 25f and 25i). A new Annex III lists possible infringements, including those relating to capital requirements, organisational requirements or conflicts of interest, operational requirements, transparency and the availability of information, and obstacles to supervisory activities;

- fines for established infringements where ESMA finds that a CCP has committed an infringement either intentionally or negligently (Article 25g). An infringement will be considered to have been committed intentionally if ESMA finds objective factors

demonstrating that the CCP (or its senior management) acted deliberately to commit the infringement. Fines may be of an amount up to twice the profits gained or losses avoided as a result of the breach or up to 10 per cent of total annual turnover in the preceding business year. However, new Annex IV provides a list of aggravating and mitigating factors, which may result in an adjustment to these figures. Nevertheless, the fine cannot exceed 20 per cent of annual turnover, but where the CCP has benefited financially, directly or indirectly, from the infringement, the fine shall be at least equal to that benefit;

- a decision by ESMA may require third country CCPs to make "effective and proportionate" periodic penalty payments in order to compel an end to infringements, the supply information or the submission to investigations or inspections (Article 25h). The penalty payment will be imposed for each day of the delay. The amount will be 3 per cent of average daily turnover in the preceding business year or, for natural persons, 2 per cent of average daily income;

- public disclosure of fines or periodic penalty payments imposed on third country CCPs, except where disclosure would seriously jeopardise the financial markets or cause disproportionate damage to the parties involved (Article 25j). This provision provides that fines and periodic penalty payments shall be enforceable and that enforcement shall be governed by the rules of civil procedure in the Member State or third country in which it is carried out;

- the Court of Justice of the European Union has jurisdiction to review any ESMA decision to impose fines or periodic penalty payments on third country CCPs (Article 25k);

- withdrawal by ESMA (partial or full) of a decision recognising a third country CCP if certain conditions are met (see further below) (Article 25m); and

- ability of ESMA to take one or more decisions when a Tier 2 CCP has committed an infringement, including requiring the CCP to bring the infringement to an end, imposing fines, issuing public notices and withdrawing recognition. (Article 25n).

Apart from in relation to withdrawal of recognition, Parliament and the Council have made relatively few changes to the Commission's proposals, although we note that the Council has suggested that third parties to whom CCPs have outsourced functions should be subject to general investigations and on-site inspections in respect of Tier 2 CCPs. Additionally, the Council has suggested removing the requirement for a third country authority to have consented to an inspection in order for it to go ahead.

Withdrawal of recognition

As regards withdrawal of recognition, the Commission's new Article 25m requires ESMA to withdraw a recognition decision in certain circumstances.

Circumstances in which ESMA shall withdraw a recognition decision:

- the CCP does not make use of the recognition within six months, renounces the authorisation expressly or has ceased to engage in business for more than six months;

- the CCP has obtained the recognition through false statements or by any other irregular means;

- a Tier 2 CCP no longer meets the Tier 2 conditions for recognition; or

- the Implementing Act providing an equivalence determination has been withdrawn or suspended, or any of the conditions attached to it is no longer satisfied.

Where ESMA considers that the CCP does not meet the Tier 2 conditions, it must inform the CCP and the relevant third country authorities prior to withdrawing recognition and request that appropriate action is taken within a set timeframe of up to a maximum of three months to

remedy the situation. However, if ESMA determines that remedial action within the set timeframe or that the action taken is not appropriate, it must withdraw the recognition.

ESMA may limit the withdrawal to a particular service, activity or class of financial instruments. When determining the date of entry into effect of the decision, ESMA must seek to minimise market disruption. The Council has added that ESMA shall provide for an appropriate adaptation period not exceeding two years.

ESMA would be required to notify the relevant third country authority without undue delay of a decision to withdraw the recognition of a CCP.

A number of relevant competent authorities and central banks may request ESMA to examine whether the conditions for withdrawal of recognition of a recognised CCP are met if they consider that this is the case. Where ESMA decides not to withdraw the recognition of the CCP concerned, it must provide full reasons to the requesting authority.

The Council has suggested that ESMA's decision to withdraw recognition should only be taken after consultation with relevant competent authorities and central banks.

In addition it has suggested that the Commission's third criterion above should be amended so that recognition is only withdrawn where the third country Tier 2 CCP has "seriously and systematically infringed" any of the Tier 2 conditions or where it is no longer in compliance with any of these conditions and has not taken remedial action requested by ESMA within a set timeframe of up to a maximum of six months. Before withdrawing recognition, ESMA would have to consider applying supervisory measures by requiring the CCP to bring the infringement to an end, imposing fines or issuing public notices. Where ESMA determines that remedial action within the set timeframe has not been taken, or that the action taken is not appropriate, it would be required to withdraw the recognition after consulting with relevant competent authorities and central banks.

These amendments, if accepted, would give some comfort to third country CCPs that their recognition could not be withdrawn on insubstantial grounds or without any ability to remedy non-compliance where appropriate.

In addition, Parliament has suggested that ESMA should withdraw recognition where it is unable to exercise its responsibilities over the CCP effectively due to failure of the third country authority to provide relevant information.

Internal committee and college for third country CCPs

The Commission has proposed the creation of a specific CCP Executive Session within the Board of Supervisors of ESMA to handle tasks related to CCPs in general, including the supervision of both EU and third-country CCPs.

However, both Parliament and Council have suggested the introduction of an additional Article 25ba of EMIR requiring ESMA to establish a college for third country CCPs. The purpose of this is to facilitate information sharing and cooperation between ESMA, competent authorities responsible for CCP supervision in Member States, competent authorities responsible for supervision of entities in which the third country CCP's operations may have an impact, such as clearing members, trading venues and central securities depositaries, as well as members of the ESCB.

The Council amendments would also require ESMA to establish a permanent internal committee for third country CCPs for the purpose of preparing decisions and carrying out tasks entrusted to ESMA under EMIR, whilst the Parliament amendments provide for the establishment of a permanent internal CCP Supervisory Committee for the purpose of preparing decisions and carrying out tasks relating to the supervision of both EU and third country CCPs. The college for third country CCPs may require the CCP Supervisory Committee to discuss specific matters in relation to a third country CCP.

Additional provisions set out the procedures for decision making within the various institutions.

Effective cooperation arrangements are an essential part of the regime enabling third country CCPs to provide services to clearing members established in the EU.

Cooperation arrangements

Article 25(7) of EMIR provides for cooperation arrangements to be established by ESMA with the relevant third country competent authorities whose legal and supervisory frameworks have been recognised as equivalent under EMIR.

Effective cooperation arrangements are considered to be an essential part of the regime enabling third country CCPs to provide services to clearing members established in the EU.

The Commission proposes to amend the current cooperation arrangements provision by:

- specifying that cooperation arrangements should be "effective";
- adding that the procedures around coordination of supervisory activities should include the agreement of third country authorities to allow investigations and inspections; and
- requiring that the arrangements specify the procedures necessary for effective monitoring of third country regulatory and supervisory developments.

The Council agrees with the Commission's proposal, but has added relevant central banks to the parties subject to the mechanism for exchange of information, as well as ESMA and third country authorities. In addition, it suggests another two points for specification in the cooperation arrangements:

- procedures for third country authorities concerning the effective enforcement of decisions adopted by ESMA; and
- procedures for third country authorities to inform ESMA, the college for third country CCPs and the central banks of issue without undue delay of any emergency situations relating to the CCP, including developments in financial markets, which may have an adverse effect on market liquidity and the stability of the financial system in the EU or one of its Member States, as well as the procedures and contingency plans to address such situations.

Parliament has proposed a different approach by splitting out the cooperation arrangements for Tier 1 and Tier 2 CCPs into separate provisions. It agrees with the Commission's proposal above in respect of Tier 1 CCPs, whilst adding a provision similar to that suggested by the Council requiring cooperation arrangements to specify the procedures for cooperation in emergency situations, including the agreement of third country authorities to inform ESMA and relevant central banks of such situations and involve them in decisions.

Moreover, Parliament has suggested adding a new Article 25(7a) in respect of cooperation arrangements for Tier 2 CCPs. In addition to the provisions applicable to Tier 1 CCPs, these arrangements would need to specify:

- the exchange of information and reporting in case of substantial changes to risk models and parameters, extension of CCP activities and services, changes in client account structure and in use of payment systems substantially affecting the EU;
- express consent by third country authorities to sharing of any information provided, subject to professional secrecy requirements;
- where rights on decisions are granted to ESMA, procedures concerning the effective enforcement of these rights; and
- procedures for cooperation in emergency situations relating to CCPs, including agreement of third country authorities to inform ESMA and the central banks of issue of such situations and to involve ESMA and the central banks in decisions. ESMA would need to consult the central banks in the elaboration of those provisions.

Finally, Parliament has proposed that if ESMA considers that a third country authority has failed to apply any of the provisions in a cooperation arrangement, it must inform the Commission confidentially and the Commission may then decide to review its equivalence determination.

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