Benoît Cœuré: European CCPs after Brexit

Speech by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, at the Global Financial Markets Association, Frankfurt am Main, 20 June 2017.

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Thank you for inviting me here today. In my short remarks I would like to say a few words about a topic that has received much attention lately: central clearing, and its importance for central banks in the context of Brexit. The extensive coverage of central counterparty (CCP) clearing in the press and other media these days shows how critical these infrastructures have become since the financial crisis.

It is easy to see why CCPs have become so important for financial stability. They helped fix a major defect in our financial system, namely the reliance on, and associated counterparty risk of, opaque bilateral over-the-counter trading of derivatives. In our highly interconnected markets, CCPs have thus become effective vehicles for reducing systemic risk in our financial system. And in doing so, they play a key part in ensuring that central banks are in a position to pursue their primary objective: price stability.

Our challenge today is to ensure that CCPs do not themselves become a risk to financial stability and, hence, generate potential impediments to the transmission of monetary policy. CCPs have grown in scale and scope to the extent that a disruption affecting a major CCP would have a significant impact on banks, markets and the instruments we rely on to perform our core central banking activities.[1]

For example, many of our key monetary policy counterparties in the euro area are participants in CCPs around the world, and are thus directly exposed to potential strains in centrally cleared markets. Asset classes such as repos, which play a direct role in our monetary policy operations, are increasingly being cleared through CCPs. Any closure of certain repo market segments due to a CCP failure would therefore inevitably limit our ability to align money market conditions with our monetary policy intentions.

Moreover, financial stress resulting from a struggling CCP could have a knock-on effect on the smooth operation of payment systems, with obvious and probably serious consequences for the real economy. In a severe crisis, we might even be expected to extend emergency lending to a failing CCP or to its participants although this would only be done at our own discretion: an automatic right to central bank liquidity could create serious moral hazard concerns.[2] In short, the safety and soundness of CCPs matters for central banks, and it matters a lot. And this is why, both at global and European level, the contribution of central banks to CCP supervision has been fully recognised. The current global standards for CCP risk management were issued jointly by central banks and capital markets commissions under the auspices of the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions, CPMI-IOSCO.[3] Furthermore, the European Market Infrastructure Regulation (EMIR) requires central banks – in their capacity as central banks of issue (CBI) of an EU currency – to be represented in the CCP supervisory colleges and to endorse supervisory decisions taken by national authorities. Central banks are key knowledge centres for furthering the understanding of central clearing and its implications for financial stability.

I believe I speak for many central bankers in saying that, as things stand today, these global standards and the EU regulatory framework provide us with appropriate tools, on the whole, for monitoring and addressing potential risks stemming from central clearing. We should not be reticent about recognising the overall progress made since the financial crisis in increasing the safety and resilience of financial market infrastructures in general, and CCPs in particular.

Nonetheless, there is no room for complacency. CPMI-IOSCO and other international bodies have been working tirelessly to address the gaps in the global requirements for CCP risk management. Certain jurisdictions are more advanced than others in establishing cooperative oversight arrangements and in inviting relevant authorities from other jurisdictions to participate. Authorities around the world have also recently started thinking seriously about supervisory stress testing for CCPs.[4] But there is still much to understand about the interdependencies between central counterparties and the broader financial system: international standard setting bodies will shortly be publishing the results of the global study group on *Central Clearing Interdependencies,* which should shed some more light on this topic. This is also an issue we need to keep in mind when discussing the recovery and resolution of CCPs – a point being considered by international fora as we speak[5] , as well as in the context of the forthcoming EU regulation, for which we will shortly be publishing an ECB opinion.

More fundamentally, of course, the UK's decision to leave the EU is prompting a significant rethink of the European approach to the supervision of systemically important global CCPs. The major clearing houses in the UK provide key services to continental banks active in securities and derivatives markets. According to our estimates, UK CCPs clear approximately 90% of the euro-denominated interest rate swaps of euro area banks, and 40% of their euro-denominated credit default swaps.[6] These figures should give you a sense of how relevant these CCPs are for the stability of the euro.

Over the years, we have concluded cooperative arrangements with the UK authorities that ensure we are appropriately involved in monitoring and assessing the risk management practices of these entities. These arrangements, which are based on both EU law under the scrutiny of the EU Court of Justice and on a dedicated memorandum of understanding between the ECB and the Bank of England, give us the confidence that in a serious crisis we would have timely access to all the information needed to take action.

What concerns us today in the context of Brexit is that the current EU regime regarding third-country CCPs was never designed to cope with major systemic CCPs operating from outside the EU. Indeed, this regime relies to a large extent on local supervision, and provides EU authorities with very limited tools for obtaining information and taking action in the event of a crisis. Reviewing this regime has therefore become urgent in the current environment. We need to ensure we can preserve a framework that ensures the safety and stability of the financial system when the UK is no longer a member of the EU.

In this regard, we think the recent European Commission proposals to amend EMIR are a step in the right direction. If adopted, they would provide the supervisors and the relevant central banks of issue with the guarantees they need in order to monitor and address risks to the EU's financial system. I therefore welcome the fact that the Commission has referred to the role that we should play as central bank of issue: we certainly need to play a strong role here, using all the instruments required to exercise our CBI competence.

It is also worth noting that most of the proposals presented by the Commission merely replicate the approaches already followed by many other major jurisdictions. In that sense, they should seem familiar to authorities and lawmakers on other continents.

We are aware that Brexit is a cause for concern in the future regulatory treatment of central clearing. In this regard, we know that there has been significant focus on one aspect of the recent Commission proposal, namely the ability of the Commission to deny recognition to a CCP that poses excessive risks to the financial stability of the EU, and to require it to establish itself in the EU if it wishes to provide clearing services in the Union. This would be just one of the tools available to EU authorities under the revised EMIR proposal. I believe that such an approach will be justified in case EU authorities are unable to adequately control risks and fulfil their mandates through other means. Ultimately, however, it will be up to the Commission and the EU legislators to decide on the specific conditions for triggering such a requirement, in the context of the forthcoming legislative discussions. The ECB and other central banks of the EU are, of course, carefully examining the Commission's proposal and the ECB will issue an opinion on it in the coming months.

Looking beyond the current political discussions, we have clear objectives, and they are shared by the entire regulatory community: namely, making sure we continue to improve the safety and resilience of the global clearing landscape, avoiding market fragmentation, and fostering cooperation between authorities.

Thank you for your attention.

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1 See, e.g., Cœuré, B. (2017), Central clearing: reaping the benefits, controlling the risks, *Financial Stability Review,* Banque de France, April 2017.

2 See, e.g., the ESCB report on the access of CCPs to central bank liquidity facilities.

3 See CPMI and IOSCO (2012), Principles for Financial Market Infrastructures (PFMI), April 2012; and CPMI and IOSCO (2014), Recovery of financial market infrastructures, October 2014.

4 See also the 2016 ESMA stress test.

5 A final CPMI-IOSCO guidance on CCP resilience and recovery will be published in July 2017. For earlier work, see CPMI and IOSCO (2016), Resilience and recovery of central counterparties (CCPs): Further guidance on the PFMI – consultative report, August 2016.

6 ECB calculations based on 2016Q4 data from trade repositories.