

EACH CCP Risk Management Summit

Keynote speech

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- CCPs play a very specific and rather technical role in supporting the safety and efficiency of financial markets across the globe. They are highly sophisticated risk management and allocation tools, which rely on a specialised and small community of risk experts, many of whom I have the pleasure of addressing today.
- The close interdependencies between FMIs and the concentration of business within a select group of CCPs make it necessary to have a holistic and global perspective to the risks that these institutions may be posing. As CCPs expand their services across markets, currencies and participants in multiple jurisdictions, there is a strong cross-jurisdictional element coming into play, not the least through cross-border linkages with clearing participants, trading venues and settlement systems.
- Against this background, a close cooperation between relevant authorities is becoming ever more essential to ensure that the risks in CCPs are adequately managed, in good and bad days, with a view to minimising systemic risk and spill-over effects across jurisdictions.
- Cooperation and coordination require high levels of trust and transparency among relevant actors to allow for a swift and

efficient reaction in crises, as well as to identify and address emerging risks early on.

- One of the best-known forms of cooperation for the supervision of CCPs are CCP colleges. In the EU, the mandatory EMIR CCP colleges are further strengthened by the CCP Supervisory Committee, which is tasked to foster and enhance supervisory convergence in the EU.
- Of course, major CCPs are a global phenomenon. In this respect, global colleges are essential to foster efficient and effective communication across authorities to support each other in fulfilling their respective mandates. I am pleased to see that the relevant authorities in the EU as well as the UK are aligned in pushing for the set-up of global supervisory colleges, where relevant, to support information sharing and supervisory cooperation among relevant authorities.
- Cooperation is not without difficulties, as one needs robust arrangements that establish workable frameworks for the exchange of non-public supervisory information. It is in this spirit that ESMA is currently reviewing and negotiating MoUs with 15 jurisdictions to improve the exchange of information on market and regulatory developments, so that risks can be better anticipated and addressed.
- This brings us to the question whether there may be limits to what can be achieved by cooperative arrangements and colleges. The size of certain CCPs and their exposures - both in terms of clearing participants and currencies cleared - can be critical, meaning that any disruption at these CCPs may have significant ripple effects for financial stability.

- In the vast majority of cases, CCPs are located within the same jurisdiction as the key market that they serve and, by implication, as their main supervisor. The EU is in a rather unusual situation as, after Brexit, key CCPs of relevance to EU financial institutions and currencies have become offshore. This requires additional reflections about how risks for EU CMs, currencies and markets can be appropriately identified and mitigated.
- Addressing some of these concerns, EMIR 2.2 established the CCP SC and granted ESMA additional powers to assess and categorize third-country CCPs depending on their systemic importance for the financial stability of the Union or of one or more of its Member States.
- As you know, ESMA determined last year that LCH Ltd. and ICE Clear Europe are considered systemically important (so-called Tier 2), subjecting them to direct supervisory control and ongoing compliance with EMIR-requirements.
- The objective is to have direct access to the CCPs to monitor risks and to be able to review key decisions of the CCPs, such as the extension of services or significant changes to risk models.
- ESMA has established this direct supervision, acting in close cooperation with the Bank of England, since the beginning of this year. This also means that the two UK CCPs are now included in our current regular stress-testing exercise.
- I am aware that many of you are interested in the ongoing review exercise conducted by the CCP SC and ESMA. As you know, the current recognition of UK CCPs is temporary and is scheduled to expire on 30 June 2022, at the same time as the European Commission's equivalence decision.

- Under EMIR 2.2, ESMA is required to undertake a comprehensive assessment of the risks to financial stability of the Union, its Member States, currencies, clearing members and clients, to determine whether the existing EMIR regulatory and supervisory toolkit suffices to address these risks and to consider the costs, benefits and consequences of a potential decision not to recognise a CCP or certain of its services.
- This technical assessment and cost-benefit analysis is built on a thorough methodology, which ESMA has made public in July 2021. The risk assessment builds on indicators to determine substantial systemic importance, including amongst other things, the size of credit and liquidity exposures of EU participants and their potential non-prefunded losses.
- The assessment against these indicators is based on data and information collected from a variety of sources and stakeholders, including EU and TC-CCPs, clearing members, clients, trading venues, but also the public sector - National Competent Authorities, Central Banks, the ESRB and other European institutions.
- The assessment also looks into a range of adverse scenarios testing the limits of the existing framework for supervision of Tier 2 CCPs in normal times, stress times or even resolution.
- The complementary analysis of the costs, benefits and potential consequences of non-recognition has a broad scope, ranging from detailed operational impacts on different stakeholders, such as the one-off and long-term cost implications, to much wider impacts, such as the impact on the EU market structure and the supervisory and resolution framework.

- This is a highly educating exercise, producing novel insights with respect to the complexity of UK CCPs and their interconnectedness with the EU financial sector.
- Based on the conclusions of the CCP SC, the ESMA Board of Supervisors will decide on whether or not to issue a recommendation to the European Commission and which content it may have, taking into account identified risks as well as impacts.
- However, risks do not end with addressing the challenges of Brexit. It is vital that we already now start addressing emerging risks which are building on the horizon for both EU and third country CCPs. In this context, discussions with stakeholders - such as the ones we are having here today – are key to developing adequate responses.
- The strong interconnectedness of CCPs with the rest of the financial sector is well known. However, we are now increasingly seeing links between the traditional financial sector and other parts of the economy, which are traditionally not supervised and are therefore not subject to risk-based regulatory and supervisory requirements.
- For example, the increasing reliance of CCPs on third-party service providers is raising attention. In the next CCP stress test exercise conducted by ESMA, we will focus on operational risk events affecting third-party entities on which CCPs rely to provide critical services, so that we may better understand dependencies and risks.
- Additionally, our annual CCP peer review this year will focus on how NCAs assess the resilience of CCPs towards cyber-risks

and their business continuity plans (BCP) in remote working arrangements.

- There is also the increasingly urgent category of environmental risk. As adverse environmental events increase in frequency and violence (floods, heat waves), CCPs have to adapt the resilience of their systems and back-up arrangements. The same is true for the entities to which they are connected.
- CCPs will also have to adapt risk models to capture potential shocks related to these trends. The most obvious implications are in the fields of commodities and energy, but we also need to consider the broader impact of climate risks on other markets. Therefore, we started working on how to best address environmental risks in the context of CCPs from a regulatory and supervisory perspective and will be looking to receive broad feedback from stakeholders the topic.
- Similar considerations apply with regard to the current surge of financial innovation, in particular for those innovations that leverage digitisation, automatization and decentralisation. There are at least three ways in which relatively new technologies may impact CCPs.
- First, through the application of these new technologies (often in combination with techniques that have been known for ages, such as cryptography), novel types of financial and non-financial assets are being created. These assets can take different forms, ranging from cryptocurrencies in a narrow sense to digital assets in the broadest sense of the word. Identical to traditional financial and non-financial assets, these newly created assets — or the fluctuation of their prices — can be directly or indirectly referenced in products that are submitted to CCPs for central

clearing. This creates challenges for both CCPs and supervisors, as these assets might have risk profiles that are difficult to square with existing risk models.

- Secondly, new technologies hold out the potential to optimise existing risk management — and potentially loss absorption — processes at CCPs. On the other hand, we must probably also ask ourselves the question to what extent current inefficiencies in the provision of clearing (and settlement) services actually follow from technological constraints and whether we might not already have much of the technology available that would be required to improve clearing and settlement processes.
- Thirdly, unlike in previous rounds of innovation, new technical propositions have the potential to affect the whole value chain for financial instruments, changing *how* clearing services may be provided in the future.
- Against this background, we also need to think about the impact of a wider adoption of novel technology-based services. Our thoughts on the implications of the adoption of these technologies could, for instance, be shaped by whether we are talking about derivatives or securities. This granularity might then of course also have to be factored in discussions on the regulatory and supervisory approach for FMIs that provide services for these respective types of financial instruments.
- There are many questions which remain to be answered. We are very pleased to see that EACH at the forefront of thought leadership in this fascinating new world of risk management by providing a forum to exchange ideas and work closely all relevant parties.



- We look very much forward to continue working closely with you and to see how our regulatory and supervisory framework can best accompany ongoing changes, and be adapted to them in the future.