



EUROPEAN CENTRAL BANK
EUROSYSTEM

ECB-PUBLIC
COURTESY TRANSLATION

Mario DRAGHI
President

Mr Mario Borghezio
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 2 May 2019
L/MD/19/135

Re: Your letter (QZ-005)

Honourable Member of the European Parliament, dear Mr Borghezio,

Thank you for your letter, which was passed on to me by Mr Roberto Gualtieri, Chairman of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 16 January 2019.

First of all, let me clarify that derivatives¹ are unrelated to our asset purchases. They are neither part of the eligible universe of assets under the ECB's asset purchase programme (APP) nor a motivation for it. The APP is determined solely by our price stability mandate.

Within the EU, the regulation of derivatives markets is the responsibility of the co-legislators, i.e. the European Parliament and the EU Council acting upon a proposal made by the European Commission. The national securities regulators ensure that EU and national rules in this field are adhered to, with the European Securities and Markets Authority (ESMA) promoting their consistent application.

Generally speaking, derivatives can help market participants and non-financial firms to better manage their risks and can support market liquidity. They can thus make a positive contribution to financial stability and the wider economy. However, the global financial crisis exposed weaknesses in the structure of derivatives markets that in some cases had contributed to systemic risk. Recognising the role of over-the-counter (OTC) derivatives (i.e. derivatives negotiated privately instead of being traded on an exchange platform) in the global financial crisis, G20 leaders committed in 2009 to reforming these markets, with the objectives of mitigating systemic risk, improving transparency and guarding against market abuse.

¹ A derivative is a contract which derives its value from an asset or a reference price and can be used for hedging or for taking financial positions.

Address
European Central Bank
Sonnemannstrasse 20
60314 Frankfurt am Main
Germany

Postal Address
European Central Bank
60640 Frankfurt am Main
Germany

Tel. +49-69-1344-0
Fax: +49-69-1344-7305
Website: www.ecb.europa.eu

This commitment was implemented mainly by introducing mandatory “clearing” for certain derivative transactions through central counterparties (CCPs), i.e. legal entities interposing themselves between counterparties to a transaction, such that they become the buyer to every seller and the seller to every buyer. In the EU, the European Market Infrastructure Regulation (EMIR)² introduced the obligation to clear certain classes of OTC derivative contract through CCPs and, for non-centrally cleared OTC derivative contracts, established certain risk-mitigation techniques. EMIR also requires that all derivatives transactions be reported to trade repositories, which are entities tasked with collecting and maintaining the relevant records.

In 2017 the European Commission published two proposals to further enhance the EMIR framework. The EMIR REFIT³ proposal seeks to make changes to EMIR in the following areas: the scope of the clearing obligation, the possibility of a clearing obligation being suspended, the reporting requirements, the risk-mitigation techniques for OTC derivatives contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories.⁴ The EMIR2 proposal seeks to amend EMIR (and the ESMA Regulation⁵) as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs.⁶ The ECB understands that these legislative changes are expected to be adopted in the coming weeks.

Considerable progress has been made in making OTC derivatives markets more transparent and resilient, and – with the exception of the requirement that OTC derivatives be traded on exchanges or electronic trading platforms – all legislative provisions are now in force, although further work is needed to fulfil the G20 objectives.⁷ As far as CCPs are concerned, this work is focusing largely on aspects of the resilience, recovery plans and resolvability of CCPs, including the establishment of related cooperative arrangements (for supervisory authorities) and crisis management groups. Work to further improve the transparency of OTC derivatives markets, in particular by enhancing data quality, is also ongoing.

² Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, OJ L 201, 27.7.2012.

³ The proposal for the amending legislation was made under the Commission’s “Regulatory Fitness and Performance” (REFIT) programme, which aims to amend and simplify existing EU legislation.

⁴ Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivatives contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories (COM(2017) 208 final). See also ECB Opinion CON/2017/42, available at https://www.ecb.europa.eu/ecb/legal/pdf/celex_52017ab0042_en_txt.pdf.

⁵ Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), OJ L 331, 15.12.2010, p. 84.

⁶ Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and amending Regulation (EU) No 648/2012 as regards procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs (COM(2017) 331 final). See also ECB Opinion CON/2017/39, available at https://www.ecb.europa.eu/ecb/legal/pdf/en_con_2017_39_eu_f_sign.pdf, and Recommendation ECB/2017/18 for a Decision of the European Parliament and of the Council amending Article 22 of the Statute of the European System of Central Banks and of the European Central Bank, available at https://www.ecb.europa.eu/ecb/legal/pdf/en_ecb_2017_18_f_sign.pdf.

⁷ See the article entitled “Looking back at OTC derivative reforms – objectives, progress and gaps”, *Economic Bulletin*, Issue 8, ECB, 2016, available at <https://www.ecb.europa.eu/pub/pdf/ecbu/eb201608.en.pdf>.

Address

European Central Bank
Sonnemannstrasse 20
60314 Frankfurt am Main
Germany

Postal Address

European Central Bank
60640 Frankfurt am Main
Germany

Tel. +49-69-1344-0
Fax: +49-69-1344-7305
Website: www.ecb.europa.eu

The ECB and the Eurosystem have been active in developing the G20's reforms, among other things through work in the Financial Stability Board and the other standard-setting bodies and the provision of input into the European regulatory process. The ECB will continue to closely monitor developments in OTC derivatives markets and infrastructures, and to contribute to improving their transparency and resilience, in accordance with its mandate.

In its role as a prudential supervisor of significant banking institutions, the ECB also monitors the effect of derivatives on individual institutions' market and credit risk exposures and the reliability of their valuation for prudential purposes.

The ECB's supervisory objective in this area is to ensure that banks focus their activities on structuring and delivering instruments that are well understood, and that the resulting positions are valued, managed and controlled in an appropriate manner. Supervisory efforts will thus continue to focus on the effectiveness and reliability of banks' control processes, the adequacy of the related governance structures, and the proper implementation of a prudent valuation framework as required by EU law⁸. With respect to the latter point, asset valuation is a supervisory priority for the Single Supervisory Mechanism in 2019 and the ECB will focus closely on valuation risk in relation to complex assets over the next two years.

Finally, to protect against the potential failure of derivative counterparties to fulfil their obligations, banks need to hold additional regulatory capital. The capital required covers the counterparty credit risk to which the banks are exposed.

Yours sincerely,

[signed]

Mario Draghi

⁸ See Article 105 of the Capital Requirements Regulation on prudent valuation.

Address

European Central Bank
Sonnemannstrasse 20
60314 Frankfurt am Main
Germany

Postal Address

European Central Bank
60640 Frankfurt am Main
Germany

Tel. +49-69-1344-0
Fax: +49-69-1344-7305
Website: www.ecb.europa.eu