



Leibniz Institute for Financial Research SAFE
Sustainable Architecture for Finance in Europe (<https://safe-frankfurt.de/>)

SAFE Finance Blog

The SAFE Regulatory Radar in January

01/31/2020

Revised regulation in the Capital Markets Union for market risk and treatment of over-the-counter derivatives, and new rules in Germany regarding clearing counterparties: a selection of financial regulatory developments from this month



At the end of each month, the SAFE Regulatory Radar highlights a selection of important news and developments on financial regulation at the national and EU level.

Capital Markets Union: New regulation for market risk

On 17 December 2019, the European Commission adopted a Delegated Regulation (<https://ec.europa.eu/transparency/regdoc/rep/3/2019/EN/C-2019-9068-F1-EN-MAIN-PART-1.PDF>) regarding the alternative standardized approach (ASA) for market risk under the Capital Requirements Regulation (CRR (<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013R0575>)). The new regulation harmonizes provisions in the CRR (Capital Requirement Regulation) after revisiting the Basel Committee's Minimum capital requirements for market risk (<https://www.bis.org/bcbs/publ/d457.htm>). Published in January 2019, it addresses the weaknesses in the prudential treatment of banks' trading book activities.

The amendments introduce revised market risk requirements and technical specifications concerning the sensitivities-based method, which is a part of the ASA (alternative standardized approach). In particular, the legislative act specifies the approaches for the calculation of own funds requirements for delta, vega, and curvature risks as well as risk weights applicable to different risk factors. Delta reflects the sensitivity of the value of a trading book position to a small change in a relevant risk factor. Vega and curvature measure the sensitivity, respectively, due to variations in the volatility of options and due to movements in the value of an option that are not captured by the delta.

The new regulation aims to ensure the operability of the ASA (alternative standardized approach) reporting requirements that apply to all institutions with large and medium-sized trading activities. The European Commission expects that the amendments will not create additional costs for institutions.

As a next step, the Council of the European Union (EU) and the European Parliament will consider the Delegated Regulation. If not objected to, the regulation will enter into force on the twentieth day after publication in the Official Journal of the EU (European Union) and will apply six months later.

Capital Markets Union: New treatment of special over-the-counter derivatives

On 18 December 2019, the Council of the EU (European Union) published a final draft (<https://data.consilium.europa.eu/doc/document/ST-15227-2019-INIT/en/pdf>) of the Delegated Regulation of the European Commission regarding the specification of the treatment of over-the-counter (OTC) derivatives in connection with certain simple, transparent and standardized (STS) securitizations for hedging purposes.

Article 11 of the European Market Infrastructure Regulation (EMIR (<https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32012R0648>)) introduced an obligation for financial counterparties engaged in OTC (over-the-counter) derivative contracts not cleared by a central counterparty (CCP) to have risk-mitigation techniques. The amendment further specifies these risk-management techniques. It aims to ensure a level playing field between the regime for covered bonds and the regime for Securitization Special Purpose Entities (SSPEs) concerning risk-mitigation techniques for non-centrally cleared OTC (over-the-counter) derivatives.

According to a new regulation, SSPEs (Securitization Special Purpose Entities) for OTC (over-the-counter) derivatives in connection with securitizations that are classified as STS (simple, transparent and standardized) would be exempted from posting and collecting initial margins and from posting variation margins in the way already implemented for covered bonds. This aims to allow for flexibility and limit risks for their counterparties.

The regulation will enter into force on the twentieth day following its publication in the Official Journal of the EU (European Union) subject to consideration by the Council of the EU (European Union) and the European Parliament.

New rules for clearing counterparties in Germany

In December 2019, the German Federal Government proposed a bill (<http://dip21.bundestag.de/dip21/btd/19/156/1915665.pdf>) to introduce special regulations for the reorganization and resolution of central counterparties following the new revised European rules for clearing counterparties (<https://www.consilium.europa.eu/en/press/press-releases/2019/10/15/capital-markets-union-council-adopts-new-clearing-house-rules/>). Therefore, changes in the national legislation on EMIR (European Market Infrastructure Regulation) are required. The draft contains the necessary changes to the German national law. In October, the SAFE Regulatory Radar (<https://safe-frankfurt.de/policy-blog/details/the-safe-regulatory-radar-in-october.html>) outlined the details of the regulation of the European Parliament and the Council of the EU (European Union) that amends the EMIR (European Market Infrastructure Regulation).

The proposed amendments will create additional regulation of credit institutions and CCP (central counterparty)s. The newly introduced rules cover both central counterparties that are licensed as CRR (Capital Requirement Regulation) credit institutions and credit institutions that are exclusively licensed as central counterparties within the meaning of Section 1 (31) KWG (Kreditwesengesetz - The German Banking Act (https://www.bafin.de/SharedDocs/Downloads/EN/Aufsichtsrecht/dl_kwg_en.html)).

In particular, a draft law establishes a default fund. Each central counterparty is obliged to have sufficient pre-financed own funds. The volume of the default fund must cover the default of the largest clearing member or the default of the second and third largest clearing members – if the risk positions of the two following clearing members are bigger than that of the largest clearing member. Supervisory and resolution authorities will receive powers that would enable them to react to the possible failure of a CCP (central counterparty).

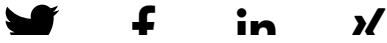
On 15 January 2020, the legislative proposal was discussed in a public hearing in the Finance Committee and met with broad approval. The Bundesbank (<https://www.bundesbank.de/de/presse/stellungnahmen/stellungnahme-der-deutschen-bundesbank-anlaesslich-der-oeffentlichen-anhoerung-des-finanzausschusses-des-deutschen-bundestags-am-15-januar-2020-822148>) pointed out that the involvement of central counterparties and the collateralization of their claims should ensure that financial transactions would be fulfilled even in case of a CCP (central counterparty)'s failure. The Federal Financial Supervisory Authority (BaFin), Deutsche Börse Group and the German Banking Industry Committee (an umbrella organization of five German banking-sector associations; in German: Die Deutsche Kreditwirtschaft) also welcomed the draft. When the new law will be adopted, it will bridge the period until an EU (European Union) law regulation comes into force.

Current public consultations

- European Commission: Public consultation on the **European framework for markets in crypto assets** (https://ec.europa.eu/info/law/better-regulation/initiatives/crypto-assets-2019/public-consultation_en). The deadline is Thursday, 19 March 2020.

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