European Association of CCP Clearing Houses

EACH response to the European Commission public consultation on the operations of the European Supervisory Authorities

May 2017

Introduction

The European Association of CCP Clearing Houses (EACH) represents the interests of Central Counterparties Clearing Houses (CCPs) in Europe since 1992. EACH currently has 20 members from 15 different European countries and is registered in the European Union Transparency Register with number 36897011311-96.

EACH appreciates the opportunity to provide feedback to the European Commission 'Public consultation on the operations of the European Supervisory Authorities' (hereafter called 'The consultation').

I. Tasks and powers of the ESAs

I.A. Optimising existing tasks and powers

I.A.1. Supervisory convergence

Question 1: In general how do you assess the work carried out by the ESAs so far in promoting a common supervisory culture and fostering supervisory convergence and how could any weaknesses be addressed?

EACH supports the regulatory convergence work performed by the ESAs and, within the CCP industry, ESMA in particular, as a means to ensure that EU legislation is applied in a similar manner across different Member States and that CCPs can compete based on similar risk management benchmark and in a level playing field. We would therefore encourage an **increased sharing of best practices between National Competent Authorities (NCAs)**. ESMA could play a leading role in implementing this idea.

In ensuring supervisory convergence, ESAs should also take into account that some CCPs are exclusively active in **local niche markets** and that supervision of these CCPs should be tailored and proportionate, while complying with global standards.

<u>Examples of positive supervisory convergence</u>

In the area of CCP clearing, ESMA has played a leading role in ensuring regulatory convergence across the EU. We would like to stress the role played by ESMA in ensuring that the application of the **portfolio margining** provisions included in EMIR in a similar manner across the EU. The publication of the **ESMA Opinion** regarding the implementation on portfolio margining requirements for CCPs under EMIR in April 2017[1] provided a useful clarification as to the way in which the crucial portfolio margining methodology applied by CCPs can be performed.

[1] ESMA Opinion Portfolio margining requirements under Article 27 of Commission Delegated Regulation (EU) No 153/2013, April 2017, available at https://www.esma.europa.eu/sites/default/files/library/esma70-708036281-18_opinion_on_portfolio_margining.pdf

Examples of improvements needed in supervisory convergence

EACH believes that ESMA's opinion on common indicators for new products and services under Article 15 and for significant changes under Article 49 of EMIR[2] has been an important step towards achieving regulatory convergence. Nonetheless, it represents an area where supervisory convergence could still be enhanced between NCAs and ESMA.

EACH considers that supervisory convergence could best support the development of new technologies and business models, to the benefit of integrated and efficient capital markets, if the current processes through which CCPs launch innovative risk management products and improve their risk management models are rationalised.

CCPs currently face the following challenges when launching a new product or improving their risk management models:

- **Timing** – The timing to approve new products is excessively long. Based on the experience of EACH members, it can, in some circumstances, take a CCP close to or longer than one year to get a new product approved compared to a few days in other jurisdictions. This can act as a competitive disadvantage and disincentivises CCP's innovation. This contrasts with certain non-European jurisdictions which operate a self-certification regime.

- **Governance**
    - **Repetition of assessment** – The process currently followed by some regulators leads to the repetition of the NCA's assessment by ESMA (and which may raise issues not directly related to the improvement proposed, and which may have already been approved by authorities during the original EMIR authorisation of the CCP).
    - **Legal certainty** - With regard to the review of risk models, stress testing and back testing (Article 49), the meaning of '*significant*' and the validation timeline are open to interpretation by the national competent authorities. ESMA should further ensure the convergence of the assessments of changes with respect to the definition of '*significance*' based on best practice. This would increase the ability for the CCP to introduce new products in a more efficient way. This would reduce differences of interpretations amongst national competent authorities, the application of different standards to different CCPs authorised in the EU and thereby increase legal certainty. As ESMA is by definition a member of each CCP College, we do believe that the main task of ESMA should be to ensure the harmonisation of the application of these provisions.

[2] ESMA Opinion on Common indicators for new products and services under Article 15 and for significant changes under Article 49 of EMIR, November 2016, available under https://www.esma.europa.eu/sites/default/files/library/2016-1574_-_opinion_on_significant_changes_for_ccps.pdf

As an example, EACH would not expect a competent authority to consider 'significant' the introduction of one additional scenario to the stress test methodology, where the CCP may already be using some 150 scenarios. A requirement to obtain approval in this case would hamper the ability of the CCP to make innovative changes to enhance its risk management practices.

While we acknowledge the work performed by ESMA in trying to address the above issue through their Opinion on '*Common indicators for new products and services under Article 15 and for significant changes under Article 49 of EMIR*'[3], we would like to stress the importance to develop best practices by ESMA on what is deemed '*significant*'. The supervisory college structure would be best suited as a tool to exchange information and to align / inform, if necessary, participating NCAs on best practices in other colleges.

Nonetheless, any of these changes deemed as '*significant*' is subject to a long and burdensome process that implies reviews by national competent authorities, ESMA and the CCP supervisory college. This impedes the ability of CCPs to adapt swiftly their risk management to market developments.

Suggested remedies

EACH believes that addressing these timing, governance and legal concerns through a more efficient process to approve new products or to modify risk models will facilitate innovation in the EU and provide efficient risk management possibilities. In order for the European market to fully benefit from these improvements, it will be crucial that the new improved mechanism is implemented as soon as possible. EACH believes that the improved implementation should not be tied to the completion of the EMIR review.

EACH proposes the following remedies:

- **Governance**
  - Only **genuinely '*significant*' proposals** should be referred for a more substantive ESMA review (see comments above on the interpretation of '*significant*'). ESMA should further ensure convergence of interpretation based on best practice and should also have a role in providing guidance to NCAs on the way in which they implement the EMIR requirements.
  - To **enhance the transparency around the schedule of College meetings** for each individual CCP (with the publication of the dates) and increase their frequency (potentially once a month - meetings can be cancelled in the absence of material submission) to ensure visibility and avoid bottlenecks.

[3] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52016PC0856

- **Legal certainty**
  - **The authority that is responsible** for determining whether a change is deemed '*significant*' based on the list of criteria above. In our view, further to the provisions of Articles 49 and 19, the authority responsible for initially deeming a change '*significant*' should be the NCA.

- **Equal treatment and competition among CCPs**
  - EACH members believe in a consistent application of the EMIR requirements by NCAs across all jurisdictions in the EU. An unclear and unnecessarily lengthy process to approve new products and risk models could put some CCPs at a disadvantage when trying to expand their activities. ESMA's role should be to ensure better convergence of different interpretations of legal provisions.

Question 2: With respect to each of the following tools and powers at the disposal of the ESAs:

- **peer reviews (Article 30 of the ESA Regulations);**
- **binding mediation and more broadly the settlement of disagreements between competent authorities in cross-border situations or cross-sectorial situations (Articles 19 and 20 of the ESA Regulations);**
- **supervisory colleges (Article 21 of the ESA Regulations);**

To what extent:

a) have these tools and powers been effective for the ESAs to foster supervisory convergence and supervisory cooperation across borders and achieve the objective of having a level playing field in the area of supervision?

While our comments in our response to question 1 focus on supervisory convergence practices, our response to question 2 focus on the functioning of supervisory colleges, based on the experience of EACH members with them.

EACH believes that the approach of having supervisory colleges at EU level is the right one: it allows for the perfect balance between leading local supervision and inclusion of authorities that may have an interest in CCPs. It allows the representation of different sensitivities and regulators, which ensures the balance of interests of all relevant market participants and Member States.

We think that college structures could however be made more effective and efficient, and therefore improve their quality of supervision while contributing to a more innovative and integrated EU capital market. Based on the experience of EACH members, the **following improvements could be considered to the functioning of supervisory colleges**:

- **Expertise** – We consider it crucial that colleges include representatives that have the relevant level of expertise in the CCP industry and/or in the concrete product cleared by a particular CCP. This expertise and knowledge is required to supervise a specific

CCP. This would make colleges more efficient because it is necessary that they provide the adequate advice. Supervisory colleges are best suited as a tool to exchange information and to align / inform, if necessary, participating NCAs on best practice in other colleges.

- **Size** - The relatively large size of colleges compared to the size of the markets supervised makes it very challenging for CCPs to launch innovative products (e.g. some colleges include a number of participants similar or larger than the number of employees of the CCP supervised). We would therefore support that proportionality is taken into account in the college structures.

Question 4: How do you assess the involvement of the ESAs in cross border cases? To what extent are the current tools sufficient to deal with these cases?

As mentioned above in our responses to questions 1 and 2, EACH believes that there is a clear role to be played by the ESAs in cross-border cases as the guarantors of efficient supervisory convergence. For CCPs, the role of ESMA is therefore important to ensure convergence within supervisory colleges.

I.A.2. Non-binding measures: guidelines and recommendations

Question 5: To what extent are the ESAs tasks and powers in relation to guidelines and recommendations sufficiently well formulated to ensure their proper application? If there are weaknesses how could those be addressed?

If ESA's guidelines and recommendations are used as tools to enforce and to achieve supervisory convergence and have 'de facto' binding character, then the process in drafting, verifying and approving guidelines and recommendations should follow an orderly regulatory process before they enter into force.

To ensure more transparency, we would welcome **greater stakeholder involvement in drafting guidelines and recommendations**, e.g. via public consultation procedures for these provisions.

In addition, a timely publication of guidelines and recommendations well ahead of the application date of the respective regulation is necessary so that market participants have sufficient time to implement. It is important that existing guidelines and recommendations are taken into account before issuing new legislation on the same subject matter whereby the new regulation may differ from existing guidelines and recommendations market participants took a lot of time and effort to comply with.

I.C. Direct supervisory powers in certain segments of capital markets

Question 19: In what areas of financial services should an extension of ESMA's direct supervisory powers be considered in order to reap the full benefits of a CMU?

Based on the experience of EACH members, **we do not have any reason to believe that the current system of supervision set out under EMIR is fundamentally flawed**. With the improvements suggested in our responses to previous questions, the supervisory structure of CCPs through colleges could be a very effective and efficient means to supervise CCPs, and we do not see a need for an extension of ESMA's direct supervisory powers over CCPs.

The potential benefits of providing ESMA with direct supervisory powers over CCPs, either full or partial, are unclear to us, and some form of local supervision or intervention of local authorities would in any case likely remain necessary. Attention should be paid to how such an approach would work in the context of the legislative proposal on CCP Recovery and Resolution[4] and, in particular, the role of CCP resolution authorities. In this context, the question is also worth bearing in mind of how desirable it is to separate supervisory responsibility from fiscal responsibility and whether it would be necessary to concentrate fiscal responsibility at an EU-level before concentrating supervisory responsibility. Fiscal responsibility is not a material issue in the context of the entities currently subject to direct ESMA supervision.

The **current college CCP supervisory college composition ensures the balance of interests of all relevant market participants and Member States**. The European Commission acknowledges that colleges are the right approach by maintaining and even extending these structures in its proposal on CCP Recovery and Resolution. Colleges are the only structures that can reconcile interests of all relevant market participants and Member States by bringing together very different supervisory authorities and ensuring the representation of all Member States and EU relevant authorities but also the various stakeholders intervening in a CCP recovery or resolution: clearing members from several Member States, CSDs, trading venues, overseeing central banks, central bank of issue, supervisor or interoperable CCPs, etc. The details of the functioning of the colleges are precisely determined by ESMA and ensure a consistent and coherent functioning across colleges, which intervene in all important decisions for the CCP: CCP authorisation, extension of activities and services provided by the CCP, changes to CCP risk models and parameters.

EMIR ensures the **right balance between CCP stakeholders recognising local supervisory differences** (e.g. the supervision of CCPs by central banks, market authorities or both, or even by the Ministry of finance). While all CCPs have in common the goal of providing safer and more efficient financial markets through the provision of CCP clearing services, European CCPs offer different products and serve a different client structures. Local supervisors are best placed

[4] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52016PC0856

to understand business models of CCPs in their jurisdictions which have a basis in a local business and regulatory environment.
EACH members believe that it would be very challenging for a single CCP supervisory structure at EU level to represent all the different interests of CCP stakeholders the way colleges currently do. We therefore agree that a combination of national competent authorities and colleges is the most appropriate supervisory structure for CCPs in the EU.

Finally, it should be noted that CCPs increasingly compete in a **global market** and CCPs in different jurisdictions may easily compete for the same products (e.g. commodity products, financial derivatives, rate derivatives). This global feature is prominent in the CCP industry and is exemplified in the number and detail of global CCP standards issued by CPMI-IOSCO and the FSB. EU CCPs therefore rely on global guidelines to be applied in the EU, which should make the task of CCP supervisory colleges easier, as they would be able to reply on globally agreed benchmarks that inform EU legislation.

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