European Association of CCP Clearing Houses

EACH response to the European Commission targeted consultation on the review of the central clearing framework in the EU

March 2022

Introduction

The European Association of CCP Clearing Houses (EACH) represents the interests of Central Counterparties (CCPs) in Europe since 1992. CCPs are financial market infrastructures that significantly contribute to safer, more efficient and transparent global financial markets. EACH currently has 18 members from 14 different European countries. EACH is registered in the European Union Transparency Register with number 36897011311-96.

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The **key messages** expressed by EACH in this response are the following:

- **EMIR Articles 15 and 49** – EACH is of the opinion that the current approach for approving products and improvements to risk models as well as the new one proposed by ESMA are either not efficient (current approach) or would not improve the existing situation regarding the approval of extension of activities as well as the significant changes to models and parameters, and would unfortunately increase complexity and duration of the process to approve the extension of products and services and changes to risk models (proposed approach). In this response we make suggestions to making CCPs more competitive by addressing the weakness we have identified.
- **CCP access to central bank facilities** - EACH would like to recommend the European Commission to consider the subject of CCP access to central bank facilities. According to a research done by EACH in 2021, the common pattern with CCP access to central banks facilities is that there is no homogeneous level of access, which should instead be ensured in the interest of financial stability and integrity, especially in case of market stress. A more standardized access to central banks facilities has several benefits, among which: limitation of exposure to insolvency risk of commercial banks, better management of investment risk, limitation of exposure to settlement risk.
- **Anti-procyclicality (APC) measures** – The recent ESMA consultation[1] on APC further increases the granularity to which EU CCPs are subject to and seems to further tighten EU CCPs' risk management ability. This not only creates an unlevel playing field with third country CCPs but most importantly represents a concern from a risk management point of view. We suggest taking this into consideration when examining the Final Report that ESMA will prepare on this subject.

[1] https://www.esma.europa.eu/sites/default/files/esma91-372-1975_consultation_paper_on_review_of_emir_rts_on_apc_margin_measures.pdf

- **CSDR** – EACH calls for a change to the CSDR legislation that removes the unnecessarily complicated duplicative system included in the CSDR Settlement Discipline Regime (SDR), which provides for two separate processes for the collection and distribution of cash penalties depending on whether one of the participants is a CCP (Article 19 SDR) or not (Article 17 SDR). Market participants should be able to use one single system through CSDs, rather than two parallel systems through CSDs and CCPs.
- **Clearing obligations by PSAs** – EACH is in favour of providing the right solutions for making clearing more attractive for PSAs. Some workable solutions already exists, e.g. the direct sponsored access model. EACH believes that a collateral transformation via the repo market could be a suitable and sustainable solution for making clearing in the EU more attractive for PSAs.
- **Post Trade Risk Reduction (PTRR)** – EACH is aware that PTRRS services are a useful tool to improve the understanding of exposures and risks in trading books and help reduce margin and capital requirements. However, we are sceptical about the need to exempt from the clearing obligation PTRR trades that are a direct result of the compression exercise (be that bilateral or multilateral).
- **Clearing by public authorities** – There are already some public entities that voluntarily clear their business at CCPs. There are general benefits of central clearing in terms of reduced counterparty credit risk as well as increased capital and netting benefits from which public entities can also benefit. CCPs are offering access to central clearing to public entities, either directly or as a client of a clearing member. Furthermore, direct and sponsored access models may also be an attractive central clearing solution for some public entities and other market participants.
- **Broadening the scope of the clearing obligation** – EACH would welcome a commitment by the European Commission to regularly apply a holistic review in detail of the product scope of the clearing obligation, and, in particular, whether it would be appropriate to introduce incentive measures to centrally clear any additional products not subject to the clearing obligation or to extend the clearing obligation to any products.
- **Expanding the list of highly liquid financial instruments** – EACH would appreciate the European Commission to take into consideration expanding the list of highly liquid financial instruments with regard to CCPs' investment policies by including, for instance, covered bonds and Money Market Funds (under certain conditions). In addition, EACH would suggest extending the average time to maturity to 5 years instead of 2.
- **Eligible collateral**
    - **Non-cash collateral** – EACH would like to point out that several CCPs in Europe historically allowed non-financials to use bank guarantees as collateral, especially energy CCPs as non-financial clearing members in those markets have limited amount of cash or other collateral assets compared to financial participants. Using non-cash collateral has several benefits, e.g. they are highly liquid products, with limited market and credit risks. In addition, the correlation of defaults in the energy sector and the financial sector has been historically low.

  - **Equity** – EACH would welcome the European Commission to take into consideration the possibility of expanding the type of collateral that could be accepted by CCPs in addition to those mentioned above, e.g. by considering the eligibility of equity as collateral.
- **Settlement Finality Directive (SFD)** – EACH is of the opinion that all CCPs could receive protection under the SFD for their default management rules and procedures if authorised or recognised by the EU. In addition, we believe that it would be helpful for indirect participants to benefit from protections if this furthers protects the CCP's default management rules and procedures.
- **Blockchain and DLT** – EACH members understand the potential impact that DLT technologies may have on the CCP business and on financial markets. However, the benefits of clearing transactions through a CCP will not become obsolete in the future. In particular, we note that certain functions of the CCP, including multilateral netting and netting between different asset classes as well as collateral and default management processes, will remain unique features of central clearing.

The above messages are complemented in our answers below, following the structure and number of the European Commission consultation and not including sections and questions not answered by EACH.

1. Scope of clearing participants and products cleared

a) Clearing obligation for PSAs

Question 1. What measures (legislative or non-legislative) do you think would be useful in order to make clearing in the EU more attractive for PSAs?

As the operators of CCPs, EACH Members are very well aware of the benefits brought by clearing services to financial stability namely, among others, the potential to reduce the counterparty credit risks that financial market participants face when they enter into transactions as well as contribute to improving efficiency in financial markets by providing multilateral netting of trades. EACH is therefore in favor of providing the right solutions for making clearing more attractive for PSAs, helping them to benefit from the robust and efficient CCP clearing environment.

Concerning the possible measures, as outlined in our response[2] to the ESMA consultation on central clearing solutions for PSAs and detailed in our responses to, and as further specified under our responses to questions 2, 11.1 and 13, EACH is of the opinion that it is important to take into consideration the reality that pension funds face due to their nature and their purposes. One of the challenges that PSAs face concerns the posting of cash for the purpose of meeting variation margin calls. However, some workable solutions already exist, as PSAs can for instance access centrally cleared repo market via existing direct clearing access models. By accessing the centrally cleared repo market, PSAs could mitigate the collateral transformation/cash management concerns for extreme but plausible market stress scenarios. Some European PSAs already make use of direct clearing access models to access the liquid CCP cleared repo markets, as European centrally-cleared repo markets are of significant size and proved ample liquidity to market participants even in times of extreme market stress.

In addition, relying on collateral transformation services already offered by clearing members to their direct clients would also be a robust and acceptable solution from the operational point of view. However, it is important to underline that such solution contains certain limitations, among which the leverage ratio and its impact on banks' balance sheets.

EACH Members would therefore, as mentioned above, believe that a collateral transformation via the repo market could be a suitable and sustainable solution for making clearing in the EU more attractive for PSAs. Repo markets in the EU are deep liquid markets which have admirably weathered multiple crises (e.g. Great Financial Crisis, Euro sovereign debt crisis, Covid-19). As per the ICMA/ERCC April 2020 Report[3], buy-side firm have been successful in managing their liquidity through the early part of March 2020 by offsetting fund outflows with positive margin

[2] https://www.eachccp.eu/wp-content/uploads/2020/06/EACH-response-to-the-ESMA-consultation-on-Central-Clearing-Solutions-for-PSAs.pdf
[3] https://www.icmagroup.org/assets/documents/Regulatory/Repo/The-European-repo-market-at-2020-year-end-130121.pdf

inflows. EACH believes that any potential bottleneck effects via clearing members could be successfully addressed via direct access or sponsored models to facilitate these processes.

As PSAs appear to have concerns with regard to access to liquidity in extreme stress scenarios, central banks could connect to the cleared repo environments and via that route reserve the option to provide liquidity directly (via CCP) or indirectly (via bank and CCP) to PSAs in extreme market conditions.

Question 2. How could the current offer by EU CCPs, including the direct/sponsored access models which were designed to also specifically address central clearing issues for PSAs, be further improved and/or facilitated?

As detailed in our responses to Question 11, Question 11.1 and Question 13, sponsored access is in Europe still at an early stage, at least when compared to the US. In Europe, for some CCPs, the margin procedures can be executed either by the agent or the sponsored bank, but some others have detected operational concerns with onboarding clients, for instance constraints related to the payment of intraday margin requirements. When developing access models CCPs have therefore installed safeguards to address the new types of risks or risk transmission arising from them, ensuring the same high risk management standards for direct/sponsored access and aligning the onboarding process including resources and credit assessment. In any case, innovation should be further promoted by addressing credit, market, operational, legal and liquidity risk management constraints. For example, if third parties were allowed to cover the day-to-day funding of margin requirements, this would reduce liquidity, legal and operational burdens for client to meet margin requirements. Further concrete EACH suggestions on how to further facilitate the adoption of the existing offer of EU CCPs through targeted legislative changes can be found in our response to Question 13.

Question 3.2 How do you see these numbers evolving overtime?

Some EU PSAs already clear their repo and OTC IRS business at CCPs. EACH Members can observe an upward trend both in terms of the number of PSA accounts onboarded and cleared volume which indicates that market participants are preparing for the entry into force of the clearing obligation. EACH members expect an increase in PSAs clearing to have a positive impact on ensuring a balanced clearing ecosystem within Europe.

In addition, EACH believes that the number of EU PSAs adopting existing market solutions will increase overtime. Also, sponsored models rely on the development of solutions from the whole eco-system surrounding the CCP offering. This ecosystem is composed of trading venues, custodian, CSDs and sponsoring agents which would need to develop offerings and competition. Hence, the market needs to develop based on viable business models requiring notably sufficient market depth and client base diversity. It is therefore important to open those models to a larger variety of clients to allow sponsoring agents to emerge and foster competition on this market segment leading to further adoption of clearing by the wider community.

b) More clearing by private entities that do not access CCPs directly

Question 11. Do you think further incentives to facilitate client clearing should be introduced?

Yes, EACH is of the opinion that further incentives to facilitate client clearing should be introduced (for details, see response to questions 11.1 and 13). We would like to highlight in particular that despite significant investments by CCPs in the development of direct and sponsored access models, as indicated in our response to Question 2 in the context of PSAs, direct and sponsored access is in Europe still at an early stage if compared to the US, where the presence of more sponsor agents and balance sheet benefits ensures more voluntary clearing.

Question 11.1. If you answered yes in question 11, please indicate which incentives should be introduced

Direct and sponsored access are more generally used by larger and/or more sophisticated clients but, as models mature, CCPs expect to see a broader range of clients subscribing. While the use of access models should be enabled to the extent possible depending on the risk profile of market participants, it should also be noted that the demand for access models is a consequence of the risk and resource management of market participants, e.g. with regard to some less sophisticated or smaller clients' capacities/resources to invest may be lower or there may be no use case for them. Rather, broader access to clearing should always ensure economic viability and operational resilience of the central clearing environment.

Nevertheless, innovation should be further promoted by addressing credit, market, operational, legal and liquidity risk management constraints. For example, if third parties were allowed to cover the day-to-day funding of margin requirements, this would reduce liquidity, legal and operational burdens for client to meet margin requirements.

In our opinion, additional factors that may be impacting the activity and uptake of direct and sponsored models are the following:

- Improved understanding by market participants of the legal requirements, the set-up and the operational processes;
- Insurance regulation did not envisage the situation of insurers becoming direct members of a CCP through direct access models, and accordingly there is a gap in the regulation preventing insurance firms from using direct access models;
- The leverage ratio treatment under Basel III should be equally explicit that unfunded contributions should not contribute to exposure under the measure. Capital charges for unfunded contributions under the Leverage Ratio may materially impact the economics of direct access models, and the business case for adoption;
- Addressing the barriers for clients to take on more responsibilities from the clearing members in the default management process, and by assessing economic incentives in relation to preferential treatments under the Basel framework.

We also kindly invite the Commission to refer to EACH's suggestions under Question 13 as to how current regulatory hurdles for clients to make full use of existing access models could be addressed

Question 12. Collateral transformation services provided by banks are often used by clients to meet liquidity needs related to margin calls. How do you consider the treatment of repos/reverse repos under the Capital Requirements Regulation: do you think there is room for better encouraging banks to provide collateral transformation services to their clients which clear in the EU?

- **Yes**
- **No**
- **Don't know / no opinion**

Question 12.1. If you answered yes to question 12, how could that be achieved while at the same time properly catering for the risks of repo transactions? Please explain your answer providing, where possible, quantitative evidence and/or examples including on the potential costs and benefits.

Repo is a balance sheet intensive activity, and the largest banks are driving the growth in repo, thanks to their ability to adapt most efficiently to regulatory demands at the same time, some clarifications and further targeted modifications with regard to the leverage ratio treatment would be justified from a risk perspective while also enabling more clearing capacity which would be beneficial to the market as a whole. The Basel Committee on Banking Supervision ('BCBS'), have addressed this impediment to client clearing services and changed the leverage ratio treatment of client cleared derivatives, such as to permit cash and non-cash forms of initial and variation margin received from a client to offset the replacement cost and potential future exposure for client cleared derivatives. This recent amendment, already applicable in the EU, may alleviate some bank clearing members' concerns on capital requirements, help make clearing more economic for such clearing members, potentially encourage new service providers to provide such services and increase the competition between themselves as well as their capacity.

From a financial standpoint, recognition of initial margin posted by clients in the leverage ratio will not only appropriately calibrate costs to support the provision of client clearing services and incentivise more market participants to use centrally clearing facilities thereby reducing counterparty risk exposures in the system but also free up additional balance sheet capacity to be used for collateral transformation purposes to support PSAs.

Question 13. How could EMIR or other legal texts be amended so that direct access to CCPs is facilitated so that smaller banks or end users are less dependent on the limited number of client clearing service providers?

- **CRR** – There is some remaining uncertainty regarding the leverage ratio treatment of unfunded default fund contributions. In order to avoid any unreasonable barriers to central clearing and inconsistencies with the risk-weighted assets (RWA) treatment of default fund contributions, the CRR should clearly state that unfunded contributions do not contribute to the exposure measure under the leverage ratio. In the absence of such a clarification, the Basel III implementation in the EU, including the introduction of a 10% credit conversion factor (CCF), could create capital charges for unfunded contributions under the Leverage Ratio. Such capital charges would materially affect the economics and thereby the adoption of direct access models.

- **Solvency II (Article 105.5 Regulation - (EU) 2009/138)** – We consider that regulators did not envisage the situation of insurers becoming direct members of a CCP through direct access models. Solvency II therefore only reflects insurance firms' exposure to clearing members and should explicitly include a beneficial risk weight for transactions cleared directly with a CCP similar to the CRR. We also consider that regulators did not envisage the situation of insurers becoming direct members of a CCP through direct access models. Solvency II therefore only reflects insurance firms' exposure to clearing members and explicitly includes an incentive to use clearing through clearing members as opposed to direct access models, which undermines the policy objective of reducing concentration risk and dependence on a few CCSP.
- **UCITS (Article 52 Directive 2009/65/EC)** – Funds regulation should exclude CCP cleared transactions from counterparty, exposure and diversification requirements similar to CRR reflecting the risk reducing nature and systemic importance of CCPs. Currently, these limits represent a major disincentive to the uptake of risk reducing and efficient direct repo and OTC clearing in the EU by asset managers as again funds regulation does not reflect on centrally cleared transactions when setting counterparty limits for UCITS, AIFs and MMFs.
- **MMFR (Article 17 Regulation (EU) 2017/1131)**
    - In order to enable an operationally efficient measure to reduce the costs of clearing, the MMFR should allow that all UCITS/AIFs that have received collateral via title transfer in a securities financing transaction (SFT) are permitted to pledge back this collateral to the provider;
    - UCITS should be enabled to net exposures when using repo markets to raise cash to meet cash variation margin requirements.

Question 15: Is there a need to amend/recalibrate UCITS counterparty exposure limits (Articles 50(1)(g) (iii) and 52 and of Directive 2009/65/EC) to distinguish cleared versus non-cleared, cleared at a Tier 2 versus other CCPs?

Yes, EACH believes there is a need to amend/recalibrate UCITS counterparty exposure limits (Articles 50(1)(g) (iii) and 52 and of Directive 2009/65/EC) to distinguish cleared versus non-cleared.

Question 15.1 If your answer to question 15 is yes, please explain the reasons providing, where possible, quantitative evidence and examples. Please also consider/explain any impact on investor protection.

Currently, the 15% and 20% limits in the MMF and UCITS V Directive act as a disincentive for UCITs, which depending on their nature are covered by either legislation, to use CCPs. The impact of these limits is exacerbated by the fact that they do not take into account the fact that a CCP becomes the buyer and seller to all centrally cleared trades and thereby hits the limit much faster than other counterparties.

As suggested in our response to Question 13 above, an amendment in the context of UCITS (Article 52 Directive 2009/65/EC) would be needed to exclude CCP cleared transactions from counterparty, exposure and diversification requirements similar to CRR reflecting the risk reducing nature and systemic importance of CCPs.

c) Encourage clearing by public entities

Question 1. To what extent do you think that the participation of public entities would add to the attractiveness of central clearing in the EU?

It can be observed that there are already some public entities that haven chosen to clear their repo and IRS contracts at CCPs voluntarily. If more public entities were to voluntarily participate in central clearing, such a signal to the market could be a "pull factor" as they are considered as attractive counterparts, particularly for global dealers thereby contributing to higher liquidity in the central clearing environment.

Question 2. What are the benefits of public entities to centrally clear? What are the costs and other drawbacks?

As a general comment, we would like to underline that public entities have the possibility to decide if they would like to clear. As mentioned above, there are already some public entities that voluntarily clear their business at CCPs. There are general benefits of central clearing in terms of reduced counterparty credit risk as well as increased capital and netting benefits from which public entities can also benefit. CCPs are offering access to central clearing to public entities, either directly or as a client of a clearing member. Furthermore, direct and sponsored access models may also be an attractive central clearing solution for some public entities and other market participants.

Question 3. What would make it more attractive for public entities (as referred to in Article 1(4) and Article 1(5) EMIR) to centrally clear? Please explain your answer providing, where possible, quantitative evidence and examples, including on the potential costs and benefits.

Please refer to our previous responses.

Question 3.2 Do you see any opportunities to facilitate central clearing for public entities with small clearable volume? Please explain your answer providing, where possible, quantitative evidence and examples, including on the potential costs and benefits.

Please refer to our responses to Questions 1, 2 and 4.1.

Question 4.1 If yes, please describe your activity/the activity of these entities in terms of products, currency denomination and, if possible, average monthly volumes

As mentioned in our response to Question1, it can be observed that some public entities have already chosen to clear their repo and IRS contracts at CCPs. EACH would invite the Commission to refer to individual responses for further details.

Question 10.3 do they / you use any form of a sponsored model to fulfil their/your obligations vis-a-vis the CCP

- **Yes**
- **No**
- **+ additional optional**

As outlined in our previous responses, public entities may choose to access CCPs through access models facilitated by a clearing agent/sponsor should they not be able to join directly or as a client of a clearing member.

Question 11.1 Where these public entities access CCPs through a general clearing member is that clearing member:

- **another public entity**
- **a profit oriented entity**
- **other**

If you answered other, please specify what type of entity.

Both options are possible.

Question 12 Have you encountered any issues regarding the post-trade reporting of transactions to which public entities are counterparties?

- **Yes**
- **No**

Question 18. Which type of central clearing do you consider most suited for public entities?

- **Directly**
- **as a client of a general clearing member**
- **through indirect clearing arrangements**

Generally, all three options are available for public entities but these are the ones currently used (please refer to our response to Questions 2 and 10.3).

d) Broaden the product scope of the clearing obligation

Question 1: Is the range of products currently subject to the clearing obligation wide enough while safeguarding financial stability?

- **Yes**
- **No**
- **Don’t know / no opinion**

Question 2.1: Please explain your answer to question 2 providing, where possible, quantitative evidence and examples including on potential costs and benefits. In particular, if you answered “yes” in question 2, please specify which types of derivatives you are referring to (i.e. what types of equity derivatives, e.g. 1 to 5 year Total Return Swaps on CAC40 vs. Euribor 3M). Please also provide an estimate of the typical flows that would be brought to clearing on a monthly basis.

EACH would welcome at this stage a commitment by the European Commission (e.g. via a specific legislative mandate) to regularly apply a holistic review in detail of the product scope of the clearing obligation, and, in particular, whether it would be appropriate to introduce incentive measures to centrally clear any additional products not subject to the clearing obligation or to extend the clearing obligation to any products. This assessment could take into account the risks, including but not limited to settlement risk and counterparty credit risk, to which counterparties in non-cleared markets are exposed, and the level of regulatory oversight over these markets. The assessment should, in our opinion, be accompanied by a legislative proposal, if appropriate.

2. Measures towards market participants

f) Transactions resulting from Post Trade Risk Reduction

Question 1. In your opinion, to what extent could the current outstanding notional amount be reduced? Could greater use of compression be done in CCPs and/or the bilateral space? Please explain your answer providing, where possible, quantitative evidence or examples, including on potential costs and benefits.

EACH is aware that Post Trade Risk Reduction (PTRR) services are a useful tool to improve the understanding of exposures and risks in trading books and help reduce margin and capital requirements. Reducing collateral is precisely one of the consequences of "risk reduction" services. While a reduction of notional amounts would not reduce the risk exposure, it does make the capital and collateral costs for the market participant cheaper. However, EACH recognizes that PTRR services have both benefits and risks. For instance, PTRR services do not bring the financial stability benefits of central clearing, as they clean up line-by-line items but do not evaluate and collect the appropriate collateral needed to face counterparty credit risk, nor do they have comprehensive default management processes to address eventual defaults.

Question 2. How should risk replacement trades resulting from Post Trade Risk Reduction services be treated with regard to the clearing obligation? Please explain your answer providing, where possible, quantitative evidence or examples, including on potential costs and benefits.

While EACH welcomes the benefits of PTRR services, and we are also mindful that they do not reproduce certain key aspects of central clearing. Although CCPs as well use PTRR services, it is essential to underline that such services come in addition to the usual CCPs' risk management and cannot substitute it. More generally, we note that the clearing obligation has not hindered the development and expansion of PTRR services, both in the uncleared and cleared space. As alluded to in our previous answer, EACH is skeptical about the need to exempt from the clearing obligation PTRR trades that are a direct result of the compression exercise (be that bilateral or multilateral). For those financial instruments that fall within clearing obligations, the simple use of a PTRR service is not a reason to exempt them from the clearing obligation. While EACH understands how moving risks back to the bilateral world would help reduce collateral requirements for individual brokers, we suggest applying caution and a thorough examination of the overall impact on financial stability.

3. Measures towards CCPs

a) Measures to expand the offer by EU CCPs

Question 1. How are EU CCPs impeded or slowed down, compared to their international peers, in bringing new products to clearing? In which ways could EU CCPs be supported in expanding their range of clearing services?

Compared to international peers, the ability for CCPs to bring new products to clearing or, importantly, improve their risk management models, is impeded by what is in our view an inefficient process under EMIR Article 15 and 49. We expand on our views on this matter in Questions 2, 3, 4 and 5 below.

In addition, for EU CCPs to be supported in expanding their range of clearing services, EACH calls for swift regulatory intervention to maintain well-functioning markets, especially in the energy clearing sector, and proposes to allow non-cash collateral by removing section 2.1, point h) in Annex 1 in RTS (EU) No 153/2013[4]. In the current context of energy prices increases in particular, the effects of the requirement for full backing are already seen in the form of participants withdrawing liquidity from CCP cleared, multilateral, transparent markets and reverting to more bilateral trading (OTC). This increases market concentration, leading to less competition and ultimately lower social welfare gains. Such a development clearly contradicts the G20 objective to create more transparent and resilient derivatives markets.

Allowing for non-cash collateral (credit lines) will enable the development of transparent and competitive regulated energy derivatives markets in the EU. It would enable renewable energy producers to support the energy transition. Regulated exchange and cleared markets play a crucial role in enabling renewable producers (non-financials) to hedge against risks stemming from a renewable system, such as price volatility and counterparty risk. In addition, the catalogue of eligible collateral can be extended to Emission certificates, also relieving market participants in the commodities field.

The EACH views concerning the use of bank guarantees are further expanded in Section 3(f) "Other issues".

Question 2. Would it be appropriate to envisage a faster approval process for certain types of initiatives which could support the objective of promoting clearing in the EU, such as expanding the range of currencies cleared? What would be the pros and cons of a quicker approval process? What other activities/services could be considered? Please explain.

[5] https://www.esma.europa.eu/sites/default/files/library/esma70-151-3373_final_report_rts_article_15_and_49_emir.pdf

Yes, EACH believes that it would be appropriate to ensure a faster approval process (as further detailed in our response to Question 3 below), not just for certain types of initiatives such as expanding the range of currencies cleared, but for all new products and improvements to risk management, as all of them will indeed be in line with the objective of promoting clearing in the EU.

In terms of pros and cons, EACH Members believe that as long as a CCP is authorised and duly supervised, a faster approval of new products and improvements to risk models should be promoted.

Question 3. Could in your view significant changes to models and parameters (Art. 49 EMIR) as well as approval of extension of activities (Art. 15 EMIR) be handled at the EU level only? For example, could ESMA be involved at an earlier stage? What other avenues would you consider to accelerate the procedures?

EACH is of the opinion that the current approach for approving products and improvements to risk models as well as the proposed new one included in the ESMA Final Report on draft regulatory technical standards on EMIR Articles 15(3) and 49(5)[5] are either not efficient (current approach) or would not improve the existing situation regarding the approval of extension of activities as well as the significant changes to models and parameters, and would unfortunately increase complexity and duration of the process to approve the extension of products and services and changes to risk models (proposed approach).

Based on a fact-finding exercise performed by EACH across 10 EMIR-authorised CCPs, the main hurdles of the current process are inefficiency and lack of transparency. We detail our views below:

- **Length of the process**
    - **Regular process** – Many changes on risk parameters and methodologies should be approved swiftly by the NCAs in order to increase CCP's resilience. However, the way that NCAs, College/ESMA approvals are managed under these Articles may potentially lead to a fading of the momentum of demand for certain activities or products and to an increase in the risks that CCPs may face if the proposed changes are not applied in due time. While some regular approval have been done in a space of 7 to 9 months, several CCPs report that it could take up to 2 years for the procedure under Article 15 (new products) to be completed and up to 2.5 years for the procedure under Article 49 (improvements to risk models).
    - **'Express process under EMIR 2.2'** – Evidence from CCPs shows that the 'express approval' process in EMIR 2.2 has resulted in some approvals ranging from 3 weeks to 6 months, far away from the objective of such an 'express' process. This process is not seen as very helpful by CCPs due to its unclear and limited scope for emergency approvals (e.g. NCAs unsure or contrary to

[5] https://www.esma.europa.eu/sites/default/files/library/esma70-151-3373_final_report_rts_article_15_and_49_emir.pdf

approving changes via this route), lack of clarity about the justifications needed for authorities to apply it and, most importantly, the systemic burden on small and incremental improvements to CCPs' risk management capabilities that the current and proposed RTS result in and which are not addressed by the 'express process'. This systemic burden and potential solutions are included in our answer to Question 5 below.

- **Lack of defined timelines** – The procedure included in EMIR can broadly be divided into 3 main steps:
  - Step 1: Decision by the NCA and College whether to pursue adaptions require an Article 15 or 49 procedure;
  - Step 2: Assessment of completeness of documents describing pursued changes;
  - Step 3: Actual assessment and decision by NCA, ESMA and College on the pursued adaption

  However, EMIR only describes Step 3 in more detail, providing a clear timeline, while Step 1 and Step 2 do not indicate any precise timeline which is needed for the process to decide whether an Article 15 or 49 EMIR procedure is triggered. Some EACH Members have experienced approval procedures that took 7 months to complete Step 1 and other 6 months for Step 2. The 'time-to-market' of new products, services and changes to risk models is increased due to a lack of clearly defined timelines.

- **Accumulation of authorisations** – The multiple layers of authorisations required (from Colleges, ESMA and the NCA) and the partially sequential process makes the whole approval procedure very heavy and complex. CCPs generally find that this process is overly complex and inefficient due to the way the current interaction between NCAs, Colleges and ESMA occurs.

Due to these shortcomings, EU CCPs are slowed down compared to their international peers, in bringing new products to clearing or implementing model changes. By way of example, US regulations provide for a 10-day self-certification process for any rule changes (e.g. clearing conditions) as well as a 1-day notification process with the CFTC for launching new products in asset classes already cleared[6].

Question 4. How could an ex-post approval process for extension of services, similar to other jurisdictions, be designed in your view, so as to balance the need for a smooth process and for ensuring adequate supervisory checks and control of risks?

See our response to Question 3 above.

Question 5. If the criteria for extension of authorisation and significant changes to models and parameters were to be introduced in the level 1 (i.e. in EMIR), so as to be objective and clear for everybody, what could the criteria be?

[6] https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-1157_technical_advice_on_third_country_regulatory_equivalence_under_emir_us.pdf

EACH would like to put forward the following suggestions:

- **Timeline** – EACH members have in some cases experienced that the decision on the materiality of a change could take up to several weeks. Thus, even if the change is in the end considered non-material, CCPs may need to wait weeks until they are able to proceed with the change. If deemed material, there may be an exchange of questions and answers which is not framed by a clear timeframe. This creates challenges for CCPs, e.g. from a client communication point of view or in the area of IT software development. As specified in our response to question 3, clarifications should provide for clearly defined timelines for all steps of the entire process of the EMIR Articles 15 and 49 procedures. The timelines should vary depending on the severity of the changes. We would suggest differentiating between minor changes (notification only a few days prior, ex-post approval), medium changes (notification 1-2 weeks prior, ex post approval) and material changes (approval process with longer times). The main criterion for materiality would be whether the change poses the risk of being incompatible with or undermining the CCPs overall risk management framework. If such a risk cannot be detected, the change would be classified as minor or medium.
- **Recalibrations of risk models**[7]
  - **Regular or minor clarifications -** A more efficient way of approving regular or minor recalibrations of risk models should be implemented in order to allow CCPs i) to take immediate actions to adjust certain parameters if necessary, in order to improve the model without a long authorization process, and ii) to support a timely introduction of new products or services based on market demand. Examples of these are smaller, risk enhancing updates to methodology (e.g. addressing 2nd line actions) which are more frequent than urgent, emergency changes.
  - **Novel features** - The assessment of any new product should focus on the novel features of the product, particularly in comparison to what is already offered. This contextual assessment is especially relevant with respect to currencies. If a CCP already clears multiple currencies and intends to add another currency to a portfolio of eligible products, it would be disproportionate to request the CCP to extend the procedure to the entire clearing and risk framework, including margin, stress testing and default fund analysis under both historical and hypothetic conditions. Generally, for new products to be launched which are within the class of products/services already covered by the authorisation, an ex-post information to the local competent authority and annual information to ESMA and the College would be proportionate.
- **Definition of 'Parameter'** – EACH Members have noted that some inputs that are regularly updated are sometimes referred to as "parameter" but EMIR itself only

[7] Please see further detail in the EACH response to the ESMA Consultation Paper "Regulatory technical standards on conditions under which additional services or activities to which a CCP wishes to extend its business are not covered by the initial authorisation and conditions under which changes to the models and parameters are significant under EMIR": https://www.eachccp.eu/wp-content/uploads/2020/11/EACH-response-ESMA-consultation-on-EMIR-Art.-15-and-49-November-2020.pdf

defines very few parameters for margining (e.g. lookback period, closeout period, confidence level). The discussion whether something is a "parameter" is also time consuming. A final definition of parameter would be helpful.

b) Payment/settlement arrangements for central clearing

Question 1. What problems do EU CCPs and clearing participants encounter with the current setup of payment and settlement arrangements available to them in the EU?

EACH would like to highlight an issue that we understand is already in the process of being addressed by authorities, but we thought nonetheless it would be worth including in our response because of the potential for removing unnecessary burden from CCPs and making EU CCPs more competitive.

The CSDR Settlement Discipline Regime (SDR) provides for two separate processes for the collection and distribution of cash penalties depending on whether one of the participants is a CCP (Article 19 SDR) or not (Article 17 SDR). This duality in the SDR RTS text leads to contradictions and unnecessary complications with regard to cash penalties involving CCPs. In our opinion, the verbatim implementation of SDR RTS Article 19 would be complex, costly, inefficient and unnecessarily duplicative for CCPs, CSDs and the members and participants of both. The coexistence of CSDR RTS Article 17 and Article 19 effectively result in the existence of two parallel, non-perfectly synchronised systems for the collection and distribution of penalties for failed settlements that CSDs, CCPs and their users would have to subscribe to when a single standardised system would achieve the same result in a much simpler and more efficient manner.

The implementation of SDR RTS Article 19 would neither contribute to nor achieve the objective described in Chapter 4.1.2 of the Impact Assessment (Annex IV to the Final Report on draft SDR RTS dated 01 February 2016), namely 'to maintain the appropriate outcome for the penalty mechanism, ensuring that no undue risk is placed on the CCP.'

EACH would like to stress that we are not aware of any market participant who is against this simplification. It is clearly supported here by EACH, and we understand is explicitly supported by CSDs and users in their responses to the consultation. Succinctly, the removal of the duplicative penalties system provided by Article 19 would resolve many issues of operational risk, legal risk and development cost, as we presented to the European Commission in previous submissions.

EACH therefore calls for a change to the CSDR legislation that removes this unnecessary duplicative system so that market participants can use one single system through CSDs, rather than two parallel systems through CSDs and CCPs.

EACH is also of the opinion, that several issues could be identified also when looking at the current Settlement Finality Directive (SFD). Such issues, highlighted in the EACH response[8] to the European Commission consultations on the review of the SFD and the Financial Collateral Directive, are the following:

- Participation in systems governed by the law of a third-country
- Designation of a third-country system if the scope was to be extended
- Participants in systems governed by the law of a Member State
- Protections granted under the SFD vis-à-vis collateral security

The EACH suggestions on how to address the issues identified in the context of SFD are detailed in our response to Question 1.2.

Another topic that we would like to submit to the Commission's attention concerns the EACH suggestion of extending the opening hours of the Eurosystem's TARGET2 system beyond 18:00 CET to increase the use of collateral provided to CCPs in EUR and reduce dependencies on other currencies such as USD. In addition, the use of alternatives already available such as the Eurosystem's Instant Payments System (TIPS) by CCPs should be facilitated as an alternative for EUR central bank money margin delivery during T2 closing times.

Question 1.2. What changes to the current payment and settlement options could be envisaged that would enhance attractiveness of EU CCPs and support the growth of EU-based clearing?

In order to address the issues concerning the SFD, some suggestions that EACH would like to put forward are the following:

- **Participation in systems governed by the law of a third-country**
    - EACH is of the opinion that all CCPs could receive protection under the SFD for their default management rules and procedures if authorised or recognised by the EU. However, this should be achieved by extending to third country systems the protections of the SFD, not merely by protecting EU participants in those systems. We would like to underline in this regard that all aspects of the default management process, in particular those involving the property of the defaulting clearing member pre- or post- insolvency, including the default actions and the application of the CCP's default waterfall, should be included in any SFD protections.
- **Designation of a third-country system if the scope was to be extended**
    - We suggest considering reviewing what could be most efficient and robust approach, i.e. a determination at EU level or at than at Member State level, having regard to the existing regimes across Member States for the designation of systems. Should an EU-level determination be adopted, we believe it could be done as part of the EMIR recognition process.

[8] https://www.eachccp.eu/wp-content/uploads/2021/05/EACH-Response-Issues-to-be-addressed-in-the-FCD-and-SFD-review.pdf

- **Participants in systems governed by the law of a Member State**
  - It should be taken into consideration that not all entities falling under a CCP clearing obligation under EMIR or entities which would like to participate in the CCP clearing are eligible system participants under the SFD or the respective local laws. In order to improve the existing situation, we suggest that:
    - The list of entities that are covered by the SFD protection be extended to cover entities that do not themselves take rights and obligations vis-à-vis the system / the system operator, but fulfil tasks that are closely related to the functioning of the system.
    - All financial counterparties and non-financial counterparties which exceed the clearing threshold under EMIR should be capable of being participants in designated systems which are CCPs
    - The SFD make it clear that it also applies to the interaction between the system / system operator and clients and indirect clients of clearing members which, for example, may directly provide collateral to the CCP or which may directly receive collateral from the CCP (see Article 48 (7) of EMIR for the latter).
- **Protections granted under the SFD vis-à-vis collateral security**
    - EACH is of the opinion that it would be helpful for indirect participants to benefit from protections if this furthers protects the CCP's default management rules and procedures. Also, the protection could be extended to protect clients (or other third parties) directly providing collateral to a CCP. The protection should therefore be the same as if the clearing member had provided it. However, CCPs should not be responsible for adding indirect participants to their systems where those participants are not known to or identified to the CCP, e.g. customers in omnibus accounts.
- **Settlement finality under the SFD**
    - EACH believes that the SFD should clearly stipulate that a system operator should also be immediately notified about the opening of insolvency proceedings (in addition to an Authority chosen by the Member State, the ESRB, ESMA and other Member States).

c) Require segregated default funds

Question 1. If EMIR were to impose the establishment of segregated default funds to certain EU CCPs to improve their attractiveness, what should be the criteria for establishing which CCPs would need to have this segregated model?

- **Number of asset classes cleared – what number?**
- **All CCPs clearing derivatives alongside other products.**
- **Other.**

EACH is of the opinion that the legislation should not favour one model (i.e. having only one asset class per default fund) over the other (i.e. having more than one asset class per default fund) since both types of models are subject to supervisory approval.

Question 1.1 Please explain your reply to question 1, also assessing the costs related to such a requirement.

We would caution against imposing any general restrictions to the default fund design models and would not agree that such a requirement would help improving the attractiveness of EU CCPs per se. In our view, the choice of the number of default funds should best be made by the CCP after consultation of its membership and based on supervisory approval. This choice depends on various criteria such as the structure of clearing members, participants and their trading behavior and the composition of asset classes cleared, which shape the risk profile of the CCP. The amount of default funds also needs to be aligned with the default management strategy of the CCP. Hence, a general requirement based on broad parameters such as the number of asset classes would risk being counterproductive as it would not adequately take into the account the diversity of CCPs.

Question 2 If EMIR or other pieces of EU legislation (e.g. the CRR) were to incentivise the establishment of segregated default funds by CCPs, how could that be achieved?

Please see our response to Questions 1 and 1.1. We would caution against both incentives and general requirements on the default fund design models.

Question 3. In your view, could a segregated default fund be established for interest rate swap/interest rate derivatives clearing only? Would that be attractive? What could be the costs and benefits of such an approach?

Please see our response to Questions 1 and 1.1

d) Enhancing funding and liquidity management conditions

Question 1. Is the current range of options for funding, liquidity, collateral safekeeping/management, investment sufficient to support the growth of EU-based clearing?

- **Yes**
- **No**
- **Don't know/no opinion**

Question 1.1 Please explain your answer to question 1 providing examples and, where possible and relevant, quantitative evidence.

One particular issue EACH Members would like to recommend the European Commission to consider is the CCP access to central bank facilities. According to a survey run by EACH in

2021[9], the common pattern with CCP access to central banks facilities is that there is no homogeneous level of access, which should instead be ensured in the interest of financial stability and integrity, especially in case of market stress. The main key findings of the survey are the following:

- **General access to central bank deposits but varied nature of this access** - Not all CCPs have access to central bank deposits, and among those that do the level and purpose of the access is varied by CCP but focused largely to access in own currency with only a few CCPs having access in multiple currencies. Amongst those with access in multiple currencies this varied pattern is continued with there being a 3 – 2 split between whether this service has been provided solely by a CCPs own Central Bank or by multiple Central Banks.
- **Fewer access to central bank liquidity and even more varied than deposits** – Access to central bank liquidity is even more varied at the top level, with CCPs' level of access varying depending on whether it is for intra-day or overnight purposes. However, this access is all in own currency only with no responding CCPs with access having so in multiple currencies, demonstrating more harmonisation in this aspect. Lastly, a 50% of CCPs with access to overnight liquidity have so without a banking license, and out of these CCPs, 50% of them have this service provided by non-Eurosystem central bank.

EACH Members would like to underline that a more standardized CCP access would bring the following important benefits to financial stability:

- **Limitation of exposure to insolvency risk of commercial banks** – It would help CCPs in limiting their exposure to commercial banks and risk associated with potential insolvency or technical outages of market infrastructures the CCP uses for the purpose of investment and/or generating liquidity.
- **Better management of investment risk** – It would allow CCPs which collect margins intra-day in multiple currencies to operate in a time window highly aligned with the markets operating hours reducing operational complexities.
- **Limitation of exposure to settlement risk** – It would limit settlement risk, in particular those related to the inability of CCPs becoming settlement agents in most of the relevant securities settlement systems.
- **Align domestic and foreign CCPs** – It would address risk issues in relation to commercial bank exposures, which are relevant to the local central bank and currency, regardless of the CCP's location.
- Subject to the independence of central banks and their right to provide access to liquidity facilities at their own discretion, it would **ensure emergency liquidity in times of extreme market conditions**.

[9] https://www.eachccp.eu/wp-content/uploads/2022/02/EACH-Note-on-CCP-access-to-Central-Banks-deposits-and-liquidity-December-2021.pdf

In this context, EACH calls for a technical rather than political discussion about central bank access by CCPs, to put this whole topic on a more consistent footing, in line with the Principles for Financial Market Infrastructures (PFMIs) and EMIR.

In addition, we would kindly request the European Commission to take into account the following suggestions that EACH has described more in detail in our response[10] to the ESMA consultation on the Report on highly liquid financial instruments with regards to the investment policy of CCPs:

- When considering expanding the list of eligible instruments to debt instruments issued or backed by private entities, ESMA and the European Commission could consider expanding conditions to include covered bonds;
- Regarding the average time to maturity of highly liquid financial instruments (point 1(c) of Annex II of the RTS (EU) No 153/2013 on requirements for central counterparties[11]) EACH suggest extending the average time to maturity to 5 years;
- EACH proposes to reconsider the list of financial instruments in order to include all Money Market Funds (EU and third-country) that meet certain requirements and improve CCPs' liquidity and risk management, as long as the issue of "gates" – amongst others – is addressed and CCPs take an adequate risk-based approach towards the products they invest in.

Further details concerning the above-mentioned EACH suggestions regarding the inclusion of covered bonds and Money Market Funds into the list of highly liquid financial instruments, as well as the proposal about extending the average time to maturity to 5 years, can be found in our response to Question 2.

Question 2. What enhancements to the existing options could be envisaged, and what would be the rationale?

As mentioned in our response to Question 1, EACH would appreciate if the European Commission could take into account some of our proposals related to the ESMA current work on highly liquid financial instruments with regards to the investment policy of CCPs, namely:

- **Inclusion of covered bonds**
    - According to EMIR Article 46, as well as Articles 37-42 of RTS No 153/2013 Chapter X, CCPs can accept covered bonds as eligible collateral under several conditions, e.g. by applying haircuts and concentration limits. Covered bonds are also considered as High-Quality Liquid Assets (HQLA) in the Liquidity Coverage Ratio (LCR) calculations related to bank liquidity requirements, under the Capital requirements Regulation (CRR). It would be desirable to align the regulation for CCP investments with these regulations. Further, certain regions may have a limited market of sovereign debt available for CCP investments.

[10] https://www.eachccp.eu/wp-content/uploads/2022/01/EACH-response-ESMA-consultation-on-highly-liquid-financial-instruments.pdf
[11] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0153&from=EN

Expanding highly liquid financial instruments to include covered bonds would increase investment space for CCPs as well as facilitate diversification among investments. Regarding the possible conditions to consider expanding the list of eligible instruments to debt instruments issued or backed by private entities, investments in covered bonds could be subject to concentration limits and also be subject to haircuts in the calculations of CCP's liquid resources (EMIR Art 44, RTS chapter VIII, articles 32-34), i.e. covered bonds considered as highly liquid financial instruments in relation to investments would be treated similar to highly liquid eligible collateral.

- **Extension of the average time to maturity to 5 years**
    - We consider an average time to maturity of maximum 2 years as too restrictive, and in particular it raised issues during the COVID-19 emergency when the investment activity, because of the limited availability of short-term securities, became more challenging. With an average time to maturity of 5 years, the benefit in diversification would clearly outweigh the added risk, as the securities are high quality, highly liquid instruments as per definition in the regulation, i.e. they can easily be mobilized anytime if respective liquidity is needed. Concerning the calculation, we believe it should be clarified whether the calculation of the average time to maturity may include non-invested funds that could be invested according to the term transformation limits defined by the CCP.
- **Inclusion of Money Market Funds (MMFs)**
    - Although understanding that under the current version of Annex II of the EMIR Delegated Regulation MMFs cannot qualify as possible investments, EACH would like to invite ESMA to consider the possibility for CCPs to invest in MMFs. The US Money Market reform in 2016 gave US Government Funds the ability to opt to not have the ability to impose "gates", at least not without a significant lead time and appropriate communication channels. Since the above possibility in the US legislation is currently not available for EU MMFs, EACH proposes to reconsider the list of financial instruments in order to include all MMFs (EU and third-country) that meet certain requirements and improve CCPs' liquidity and risk management, as long as the issue of "gates" – amongst others – is addressed and CCPs take an adequate risk-based approach towards the products they invest in. This is meaningful for investment of funds in currencies where a CCP has no central bank access in order to avoid unsecured exposures. To make MMFs an adequate investment option, EACH suggests that the requirements that MMFs should comply with may include the following:
        - The ability to redeem an interest and make payment in satisfaction thereof with same day value following a redemption request that meets appropriate cut off times (i.e. no application of redemption gates);
        - The fund must be appropriately registered by its competent authority and sponsored by authorised credit institutions, authorised investment firms, authorised or registered alternative investment funds, or third-country equivalent firms and institutions.

f) Other measures

Question 1. Are there other measures which could potentially help improve the competitiveness of EU CCPs both in terms of the products they offer and the services they provide?

- **Yes**
- **No**

Question 1.1 If your answer to question 1 is yes, please explain and provide supporting evidence of the potential costs and benefits

EACH would like to highlight that the recent ESMA consultation[12] on anti-procyclicality further increases the granularity to which EU CCPs are subject and seems to further restrict the possibility for EU CCPs to exercise their independent risk management ability. This raises concerns from a risk management point of view, given the increasingly limited ability for CCPs to tailor the risk management approach to the products and markets within the discretion provided for in EMIR. But importantly, and in view of the objective of the Commission wishing to seek views on how to improve the competitiveness of EU CCPs, this is a current case in point where ESMA has announced its intention to harmonise further an aspect of CCP risk management on which international work is ongoing and not yet complete. The consequence of this work is potentially to further tighten a framework around European CCPs that will not apply to those in third countries, thereby potentially creating a competitive disadvantage for CCP clearing in Europe. Certainly, it would appear that the European legislative backdrop and RTS parameters are not conducive to developing new approaches to CCP risk management and are not likely to be so under the current framework. This compares unfavourably with approaches to CCP regulation in certain third countries.

In addition, and particularly important in the context of the current volatility in energy markets, Article 46 of EMIR allows the use of bank guarantees as collateral by non-financial clearing members. Non-financial counterparties used to trade under an exemption from the EMIR requirement for bank guarantees to be fully backed by collateral which expired in March 2016. The requirement to fully back bank guarantees in reality leads to an almost ban on the use of bank guarantees as collateral for non-financial participants. Consequently, the discontinuation of the exemption had a significant adverse effect on the clearing of energy derivative instruments. Although the problem was highlighted to the EU institutions and ESMA, no solution was implemented despite the fact that the risks of using bank guarantees as collateral can be measured and controlled. We further detail our call for the Commission to consider non-fully backed bank guarantees in our response to section 7b 'Other issues'.

Furthermore, and still within the topic of the list of collateral accepted by CCPs, we would urge the European Commission to consider adding shares to the list of eligible collateral under

[12] https://www.esma.europa.eu/sites/default/files/esma91-372-1975_consultation_paper_on_review_of_emir_rts_on_apc_margin_measures.pdf

EMIR Article 46 and related RTS 153/2013. Shares that are part of a major stock index and have a proven record as a reliable source of liquidity (i.e. stock price decline < 40% during a 30-day stress period) are considered as High-Quality Liquid Assets (HQLA) in the Liquidity Coverage Ratio (LCR) calculations related to bank liquidity requirements, under the Capital Requirements Regulation (CRR).[13] It would be desirable to align the regulation for CCP collateral with these regulations. Noting that liquidity on certain shares can be higher than that of certain bonds that qualify as HQLA, the opportunity to further diversify CCP eligible collateral would be welcomed by CCPs and clearing members, since it could reduce concentration risk and improve collateral management. Therefore, subject to certain criteria including appropriate concentration limits and haircut, we believe shares would be a welcome addition to the list of eligible collateral. Allowing CCPs to receive shares as collateral will not be new from a global perspective (e.g. we understand that in the United States, CCPs are able to accept shares as collateral).

Finally, our response to section 7(b) of the consultation includes other suggestions to further improve the competitiveness of EU CCPs, such as the need to ensure no competitive disadvantage or regulatory arbitrage regarding minimum margin requirements for Exchange-traded derivatives (ETDs), clarification of the spot commodities clearing legal environment, simplification and streamlining of regulatory reporting and considerations about how to improve porting of clients.

[13] https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op218~801632b377.en.pdf

5. Supervision of CCPs

a) Identifying costs related to current supervisory framework and benefits with a stronger role for EU-level supervision

Question 1.1. Please explain your answer providing, where possible, quantitative evidence or examples. If you indicated 'Other', please specify what was intended.

EACH would like to underline in particular that we would rather not express any preference regarding which authority may supervise CCPs.

Concrete data regarding the regulatory compliance costs involved in today's supervisory framework for EU CCPs may be provided by EACH Members in their individual responses.

6. EMIR and other Regulations/Directives

Question 1: Should amendments be introduced to the following legal instruments to better harmonize the requirements applicable to entities active in OTC derivatives

	1 (strongly agree)	2 (rather agree)	3 (neutral)	4 (rather disagree)	5 (strongly disagree)	6 no opinion
Link between EMIR and MiFID withregards to the definition ofOTC derivatives,central clearing requirement, DTO determination						X
CRR and CRD	X					
UCITSD	X					
AIFMD	X					
MMFR						
Solvency	X					
Other amendments to EMIR in relation to non-centrally cleared derivatives	X					

Question 1.2. Please explain your answer to question 1. If you think that amendments are required, please clearly indicate which amendments should be introduced, their rationale as well as their potential costs and benefits

As further specified in our responses to other questions of this consultation, we would suggest including the following amendments to EMIR and other Regulations/Directives:

- **EMIR**
  - **EMIR Refit Article 1(24)(c)** – EMIR could be amended in a way that encourages Pension Scheme Arrangements (PSAs) clearing and fosters client access;
  - **EMIR Article 85(3a(e))** – The list of highly liquid financial instruments foreseen in the Legislation could be amended to include covered bonds and MMFs. EACH also suggests allowing the acceptance of non-cash collateral. In addition, as explained under Question 2 of section "Enhancing funding and liquidity management conditions", EACH is of the opinion that an average time to maturity of maximum 2 years is too restrictive, and suggests to extend it to 5 years.
  - **EMIR RTS (EU) No 153/2013, Article 28** – The recent ESMA consultation[14] on anti-procyclicality further increases the granularity to which EU CCPs are subject to and seems to further tighten EU CCPs risk management ability. This not only creates a unlevel-playing field with third-country CCPs but most importantly represents a concern from a risk management point of view. We suggest taking this into consideration when examining the Final Report that ESMA will prepare on this subject; please also refer to our comments under section 7(b) in this context.
  - **EMIR Articles 15 and 49** – The current process to approve products and improvements to risk models under EMIR Article 15 and 49 is inefficient. We would like to kindly request the European Commission to take into consideration the issues highlighted by EACH in the responses to Questions 2,3 and 4 of Section 5(a) "Measures to expand the offer by EU CCPs".
- **UCITSD (Article 52 Directive 2009/65/EC)**
  - UCITS (Article 52 Directive 2009/65/EC) – Exclude CCP cleared transactions from counterparty, exposure and diversification requirements similar to CRR reflecting the risk reducing nature and systemic importance of CCPs.
- **MMF (Article 17 Regulation (EU) 2017/1131)**
  - Allow that all UCITS/AIFs that have received collateral via title transfer in an SFT are permitted to pledge back this collateral to the provider;
  - Allow UCITS to net exposures when using repo markets to raise cash to meet cash VM requirements.
- **Solvency II (Article 105.5 Regulation - (EU) 2009/138)** - Explicitly adopt beneficial risk weight for CCP cleared transactions cleared directly with CCP similar to CRR.

[14] https://www.esma.europa.eu/sites/default/files/esma91-372-1975_consultation_paper_on_review_of_emir_rts_on_apc_margin_measures.pdf

7. EMIR and other Regulations/Directives

a) Blockchain and Distributed Ledger Technology (DLT)

Question 1. Could blockchain and DLT be used in the field of clearing to improve the attractiveness and efficiency of EU CCPs and clearing markets?

- **Yes**
- **No**
- **Don't know / no opinion**

Question 1.2. If you answered yes to question 1, please detail your response.

EACH members understand the potential impact that DLT technologies may have on the CCP business and on financial markets. CCPs are involved in initiatives to encourage the development and to explore the application of such technologies. More specifically, EACH believes that DLT might bring benefits in the following areas of CCP activities:

- **Reconciliation process**
  - DLT may not only make the reconciliation process faster and more efficient but it may potentially make it unnecessary since the records are shared among participants. However, it currently seems unclear what the impact would be on the current value chain of market infrastructures: trading venues, CCPs, CSDs, CSD participants, final beneficiaries, etc. While every actor of the value chain currently plays a very specific role, market infrastructures are in constant evolution as a result of innovation and client demand, and therefore changes to the value chain as we know it cannot be discarded. CCPs have a proven track record of market adaption as shown by the constant evolution of their risk management techniques subject to client demand and in line with regulation.
- **Data for reporting**
  - EACH generally believes DLT could potentially facilitate the collection, consolidation and sharing of data for reporting. However, DLT would operate in parallel to other systems, thus requiring reference to multiple sources in order to maintain complete oversight. Even assuming full deployment of DLT where applicable, certain processes or asset classes may not be suited to a DLT environment and may operate on separate systems, thus requiring again multiple sources to be consulted in order to maintain a complete picture. Moreover, a single source of truth implies a single DLT system in use. After consideration by the industry, it may be determined that there is not a single DLT that will serve all of the needs of the market, requiring multiple DLTs to be deployed and more than one record to be monitored. Further, generally we question some assumptions that DLT can handle a theoretically unlimited amount of information at an increased speed.

- **Counterparty risk of certain securities transactions**
    - DLT presents the possibility to reduce the settlement cycle, thus reducing counterparty risk. It should be noted however that shorter settlement cycles (and even T-instant) are not a unique advantage of DLT, and indeed could be performed on many current systems. In the case of CCPs, DLT may indeed eliminate the counterparty risk of certain transactions (e.g. securities and repos) and remove the need for CCP clearing for some contracts, but this is only in those instances where the trading is either on DLT or can be transferred to the clearing system in real-time (if outside DLT), e.g. T-instant.
- **Collateral management**
    - EACH believes that DLT could potentially make to collateral risk management more efficient, but such efficiency will depend on the number of asset classes (market segments) made available on the DLT (transaction type bundling), which in turn will depend on the appropriateness and applicability of DLT for each asset class and the ability of each participant to support the DLT connections. Particular benefits (such as netting and the resulting decrease of collateral requirements) will be impacted by the scope of assets available on the ledger. Several questions remain open in this regard, such as how exactly the right of pledge will work under DLT going forward.

In addition, EACH would like to underline that the benefits of clearing transactions through a CCP will not become obsolete in the future. In particular, we note that certain functions of the CCP, including multilateral netting and netting between different asset classes as well as collateral and default management processes, which cannot be applied as effectively or across multiple counterparties in a DLT environment, will remain unique features of central clearing even if the industry moves to a distributed ledger. The benefits of CCP clearing indeed go beyond settlement. DLT does not reduce the risk of a bilateral counterparty defaulting on obligations to its trading partners, a risk that CCP clearing reduces by guaranteeing performance of trades. CCPs additionally perform a series of risk, collateral, and default management processes that cannot be directly replaced by DLT.

b) Other issues

Please provide any further suggestions to improve the attractiveness and competitiveness of EU CCPs and clearing markets, as well as the robustness of EU supervisory arrangements in order of impact and priority. Please provide supporting evidence.

Further suggestions that EACH would kindly ask the European Commission to take into consideration are the following:

- **MPOR for ETDs** – EACH members recommend that, if EU CCPs are to be more competitive as is the aim of the Commission, consideration of minimum margin requirements for ETDs (e.g. MPOR or APC) should align to international standards and outcomes, to ensure no competitive disadvantage or regulatory arbitrage.

- **Clarification of the spot commodities clearing legal environment** - At least seven EU CCPs are active in these markets they have found challenges in them which currently slow down the provision of these services by EU entities with other EU entities and third-country ones.
- **Simplification and streamlining of regulatory reporting** – Electricity and gas derivative contracts are covered by reporting obligations stemming from four pieces of legislation: namely EMIR, MiFID II/MiFIR, REMIT and MAR. This constitutes a heavy reporting burden for energy exchanges and clearing houses as well as for market participants. Consequently, there is a need to streamline the requirements in order to avoid double reporting. For example, trades that have to be reported under REMIT or MiFID II/MiFIR should not need to be reported again, if they have already been reported under EMIR.
- **Porting of clients** – As outlined in our response[15] to the CPMI-IOSCO discussion paper on client clearing access and portability, porting is a crucial feature of an adequate default management process and requires a proper regulatory framework and incentives (e.g. upcharges for lack of a back-up CCSP) as well as an insolvency regime that does not prevent the CCP from porting clients of a clearing member (e.g. a gross margining regime – so that there is collateral held in the CCP in order to support a clearing member default – as well as a negative consent regime, even if temporary).
- **Non-cash collateral** – As described in our response to sections 3(a) and 3(f), EACH kindly suggest authorities to consider the possibility of using non-cash collateral such as non-fully backed bank guarantees as collateral to benefit of non-financial users in particular. Several CCPs in Europe historically allowed non-financials to use bank guarantees as collateral, especially energy CCPs as non-financial clearing members in those markets have limited amount of cash or other collateral assets compared to financial participants. This is particularly the case for the CCPs in the following jurisdictions: Denmark, Finland, Hungary, Poland, Portugal, Spain, Sweden and Norway.

  We would like to particularly emphasise the benefits of using bank guarantees:
  - **Highly liquid products**
    - On first demand, bank guarantees create a no accessorial, abstract obligation to the beneficiary, putting the beneficiary in a strong legal position ("pay first, sue later"). The guarantor remains liable even if the underlying obligation is extinguished, it must pay immediately and cannot object. The characteristic of bank guarantees as unconditional, irrevocable and on- first-demand, make them "highly liquid". For these continuing guarantees the guarantor assumes liability for any past, present and future obligations owed by a debtor to a lender or creditor. Even where the amount owing has been completely paid, the guarantor can still be liable under that line of credit if there is a subsequent indebtedness.

[15] https://www.eachccp.eu/wp-content/uploads/2022/03/EACH-response-CPMI-IOSCO-discussion-paper-on-client-clearing-access-and-portability-February-2022.pdf

- **Limited market risk**
  - The market risk of bank guarantees is limited in terms of volatility. In times of market stress, members might find it difficult to increase the bank guarantee limits. This is mitigated by concentration limits on posted collateral per member, i.e. limited percentage of its total collateral issued by one issuer.
- **Limited credit risk**
  - The credit risk is managed by only accepting guarantees issued by investment grade rated banks with a certain minimum rating, external rating and evaluation using an internal score card. A deterioration of a bank guarantee issuer's credit worthiness will have implications on the applied haircuts and/or eligibility of the bank guarantees issued by the relevant bank. The lower the credit rating, the higher the haircut.
- **Low correlation between financial and energy sector**
  - EACH members insist that eventual risks can be measured and controlled, and they do not motivate that bank guarantees need to be fully backed. The CCP is only exposed to a loss in case both the member and the issuing bank are defaulting simultaneously. The correlation of defaults in the energy sector and the financial sector has been historically low. Nevertheless, issuers may be added to the credit watch list for extra monitoring. If an issuer defaults, the member is required to immediately find another issuer or collateral.

- END -