



European Securities and
Markets Authority

Consultation Paper

Report on highly liquid financial instruments with regards to the investment policy of central counterparties (EMIR Article 85(3a(e)))



Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 3. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **24 January 2022**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading '[Data protection](#)'.

Who should read this paper?

All interested stakeholders are invited to respond to this consultation paper. In particular, responses are sought from central counterparties (CCPs), clearing members, direct or indirect clearing clients, money market funds managers, UCITS managers, trade associations and the market community more generally.

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1 Executive Summary

Reasons for publication

ESMA was originally mandated to submit a report to the European Commission (EC) by 18 May 2020 on whether the list of financial instruments that are considered highly liquid with minimal market and credit risk, in accordance with Article 47 of EMIR, could be extended and whether that list could include one or more money market funds authorised in accordance with Regulation (EU) 2017/1131 of the European Parliament and of the Council¹.

Following the market turmoil in March and April 2020 due to the COVID-19 pandemic, ESMA had decided to pause its work in order to better analyse the sources of the liquidity strains observed in the short-term funding market. Based on the lessons learned from the crisis, ESMA decided to resume its work and issues a consultation paper in order to receive additional feedback on the implications of potential changes to investment policies for CCPs and the broader market.

Contents

Section 2 provides an introduction to this consultation paper. Section 3 provides background on the current regulatory framework and investment practices of CCPs. Section 4 explores the benefits and disadvantages of a potential extension of the list of highly liquid financial instruments. Section 5 focuses on the appropriateness of including money market funds in the list of allowed investments for CCPs.

Next Steps

ESMA will consider the feedback it receives from this consultation by 24 January 2022 and expects to publish and submit a final report to the European Commission in Spring 2022. The report will concentrate on the identified areas of extension of the list of possible investments for CCPs. Depending on the recommendations made in this report, an amendment to RTS 153/2013 on CCP requirements may be needed as a final deliverable.

¹ Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds (known as 'MMFR') (OJ L 169, 30.6.2017, p.8)

2 Introduction

1. The EU Regulation 648/2012² (hereafter referred to as 'EMIR') requires EU CCPs to invest their financial resources only in cash or in highly liquid financial instruments with minimal market and credit risk. Under EMIR, highly liquid instruments for CCP investments are restricted to debt instruments respecting a list of cumulative conditions on the issuer or guarantor, the CCP's credit and market risk assessment, their average time-to-maturity, denomination, transferability, marketability or reliability of price data.
2. Under Article 85(3a(e)) of EMIR³, ESMA has been mandated to provide⁴ a report to the Commission on whether the list of financial instruments that are considered highly liquid with minimal market and credit risk, in accordance with Article 47 of EMIR, could be extended and whether that list could include one or more money market funds (MMFs) authorised in accordance with EU Regulation 2017/1131⁵ on money market funds (or 'MMFR').
3. Following the market turmoil in March and April 2020 due to the COVID-19 pandemic, ESMA had decided to temporarily pause its work in order to better analyse the sources of the liquidity strains observed in the short-term funding market and understand their implications for CCPs and their investment policies. Based on the lessons learnt from the crisis, ESMA decided to resume its work.
4. The main objectives of the report are firstly to generally assess whether the scope of financial instruments which are considered highly liquid with minimal market and credit risk should be extended and secondly to assess more specifically if MMFs authorised under MMFR (or a sub-set of them) should be included in this list.
5. The first part of ESMA's mandate may be very extensive as it implies potentially exploring all types of financial instruments which are not already considered as highly liquid and assessing whether they should be considered as such, under certain conditions.
6. ESMA proposes to frame the discussion to financial instruments for CCP investments in line with the Principles for Financial Market Infrastructure (PFMI) to ensure consistency with international standards and uses this public consultation to gather information from stakeholders on the expected benefits and downsides of potentially extending the list of investment possibilities for EU CCPs and the type of financial instruments which could be considered. A specific focus is brought to MMFs in the second part of the consultation, as well as on the potential impact of ongoing policy discussions on their liquidity profile.
7. Following this public consultation, ESMA will issue a final report focusing on the identified areas for a potential review of the regulatory requirements for CCP investments.

² Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories Text with EEA relevance, [Consolidated version](#)

³ Regulation (EU) 2019/834 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 648/2012, [EUOJ](#)

⁴ The deadline mentioned in EMIR is 18 May 2020.

⁵ Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds (Text with EEA relevance, [EU OJ](#))

3 Current regulatory framework and practices

3.1 International standards

8. The CPMI-IOSCO Principles for Financial Market Infrastructures⁶ (PFMIs) are the international standards for FMIs, including CCPs, issued to strengthen and preserve financial stability.
9. Principle 16 on custody and investment risks states that *“an FMI should safeguard its own and its participants’ assets and minimise the risk of loss on and delay in access to these assets. An FMI’s investments should be in instruments with minimal credit, market, and liquidity risks.”*
10. It further adds that *“an FMI’s investment strategy should be consistent with its overall risk-management strategy and fully disclosed to its participants, and investments should be secured by, or be claims on, high-quality obligors.”*
11. The level of stringency for CCP investments is deliberate, as the PFMI establishes distinct and slightly less stringent standards for the collateral collected by the CCP from its members in accordance with Principle 5.
12. While it requires that *“the FMI should generally limit the assets it (routinely) accepts as collateral to those with low credit, liquidity, and market risks”*, FMIs can accept a broader range of collateral as long as the FMI applies adequate haircut and concentration limits.
13. Most importantly, Principle 5 does not limit investments secured by or claims on high-quality obligors.
14. Similarly, Principle 16 on investment risk requires that *“these investments should allow for quick liquidation with little, if any, adverse price effect”*, while Principle 5 on collateral states that FMIs should avoid assets which cannot be liquidated *“without significant adverse price effects.”*
15. In effect, the PFMI establish a hierarchy by which the investment of CCPs have to follow the most stringent rules to avoid reintroducing market or credit risk into the CCP.

3.2 Current regulatory framework for CCP investment under EMIR

16. EMIR is in line with the PFMI as Article 47 of EMIR, which deals with the investment policy of CCPs, closely follows Principle 16 and states that *“a CCP shall invest its financial resources only in cash or in highly liquid financial instruments with minimal market and credit risk. A CCP’s investments shall be capable of being liquidated rapidly with minimal adverse price effect.”*
17. With respect to the definition and scope of highly liquid financial instruments, ESMA was mandated to develop draft regulatory technical standards (RTS) specifying the

⁶ CPMI-IOSCO, [Principles for financial market infrastructures](#), 2012

conditions applicable to financial instruments for them to be considered highly liquid and bearing minimal credit and market risk as referred to in paragraph 1 of Article 47, after consulting the EBA and the ESCB. The Commission Delegated Regulation (EU) No 153/2012⁷ (hereafter referred to as the 'EMIR Delegated Regulation'), based on ESMA's RTS, was endorsed and then entered into force in 2013.

18. Article 43 of the EMIR Delegated Regulation requires that financial instruments in which the CCP invests to be *"debt instruments meeting each of the conditions set out in Annex II."*

The Annex II lists the conditions applicable to highly liquid financial instruments:

- "(a) they are issued or explicitly guaranteed by:*
- (i) a government;*
 - (ii) a central bank;*
 - (iii) a multilateral development bank as listed under Section 4.2 of Part 1 of Annex VI to Directive 2006/48/EC;*
 - (iv) the European Financial Stability Facility or the European Stability Mechanism where applicable.*
- (b) the CCP can demonstrate that they have low credit and market risk based upon an internal assessment by the CCP. In performing such assessment the CCP shall employ a defined and objective methodology that shall not fully rely on external opinions and that takes into consideration the risk arising from the establishment of the issuer in a particular country;*
- (c) the average time-to-maturity of the CCP's portfolio does not exceed two years;*
- (d) they are denominated in one of the following currencies:*
- (i) a currency the risks of which the CCP can demonstrate that it is able to manage; or*
 - (ii) a currency in which the CCP clears transactions, in the limit of the collateral received in that currency;*
- (e) they are freely transferable and without any regulatory constraint or third party claims that impair liquidation;*
- (f) they have an active outright sale or repurchase agreement market, with a diverse group of buyers and sellers, including in stressed conditions and to which the CCP has reliable access;*

⁷ Commission Delegated Regulation (EU) No 153/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on requirements for central counterparties Text with EEA relevance, [Consolidated version](#)

(g) *reliable price data on these instruments are published on a regular basis.”*

19. Furthermore, Annex II states that derivative contracts can also be considered invested in if they are entered into for the purpose of:

“(a) hedging the portfolio of a defaulted clearing member as part of the CCP’s default management procedure; or

(b) hedging currency risk arising from its liquidity management framework established in accordance with Chapter VIII.

Where derivative contracts are used in such circumstances, their use shall be limited to derivative contracts in respect of which reliable price data is published on a regular basis and to the period of time necessary to reduce the credit and market risk to which the CCP is exposed.”

3.3 Requirements for CCP investments in third-countries

20. While the PFMI standards have strived to deliver a common minimum standards for CCPs, divergences exist across jurisdictions to address local market structures, supervisory practices and domestic preferences.

3.3.1 US CFTC requirements

21. The CFTC does not distinguish the investment of client (customer) money by a clearing member (futures commission merchant) or a CCP (derivatives clearing organization).
22. Under the Commodity Exchanges Act, Regulation 1.25⁸ permits investment of customer funds in: (i) Obligations of the United States and obligations fully guaranteed as to principal and interest by the United States (U.S. government securities); (ii) General obligations of any State or of any political subdivision thereof (municipal securities); (iii) Obligations of any United States government corporation or enterprise sponsored by the United States government (U.S. agency obligations); (iv) Certificates of deposit issued by a bank (certificates of deposit) as defined in section 3(a)(6) of the Securities Exchange Act of 1934, or a domestic branch of a foreign bank that carries deposits insured by the Federal Deposit Insurance Corporation; (v) Commercial paper fully guaranteed as to principal and interest by the United States under the Temporary Liquidity Guarantee Program as administered by the Federal Deposit Insurance Corporation (commercial paper); (vi) Corporate notes or bonds fully guaranteed as to principal and interest by the United States under the Temporary Liquidity Guarantee Program as administered by the Federal Deposit Insurance Corporation (corporate notes or bonds); and (vii) Interests in money market mutual funds (discussed in section 5). ESMA notes that the list of permissible investments was recently expanded to include sovereign debt issued by

⁸ [Electronic Code of Federal Regulations \(e-CFR\) Title 17 - Commodity and Securities Exchanges CHAPTER I - COMMODITY FUTURES TRADING COMMISSION PART 1 - GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT Customers' Money, Securities, and Property § 1.25 Investment of customer funds.](#)

France and Germany, as well as to enter in reverse repo agreements on these sovereign debts in 2018⁹ under certain conditions.

3.3.2 US SEC requirements

23. The US SEC requirements for CCPs are codified in Rule 17Ad-22¹⁰ of the Securities Exchange Act. Covered clearing agencies are required to establish, implement, maintain and enforce written policies and procedures reasonably designed to safeguard the covered clearing agency's own and its participants' assets by minimizing the risk of loss and delay in access to these assets in order to invest such assets in instruments with minimal credit, market, and liquidity risks (Point (e)(16)).

3.3.3 Hong Kong requirements

24. The general framework for recognised and designated CCPs is introduced by the Securities and Futures Ordinance¹¹, where it establishes in Division 3 the conditions and duties to be recognised by requiring that *"risks associated with its business and operations are managed prudently"* suggesting that the CCP should make its investments in assets with a minimum risk in order to maintain sufficient liquidity to perform its functions.
25. However, ESMA is not aware of other or more detailed requirements for CCP investments.

3.3.4 Singapore requirements

26. The legal framework regarding CCPs' investments is detailed in the Securities and Futures Act¹². In particular, the Division 2 on "Regulation of Approved Clearing Houses" introduces in its paragraph 60 (1)(c) that the Authority may issue Regulations on *"how the clearing house can invest the customers' money"*.
27. In addition, the Securities and Futures (Clearing Facilities) Regulation 2013¹³ introduces a more precise framework in paragraphs 24 and 25 on how a CCP shall invest customers' money:

"an approved clearing house may invest any money or assets deposited or paid for or in relation to the contracts of a customer of a member of the approved clearing house (...) in the following:

- (a) *debentures of the Government;*

⁹ US Federal Register, [CFTC Order Granting Exemption From Certain Provisions of the Commodity Exchange Act Regarding Investment of Customer Funds and From Certain Related Commission Regulations](#), July 2018

¹⁰ Rule 17Ad-22: [17 CFR § 240.17Ad-22 - Standards for clearing agencies. | CFR | US Law | LII / Legal Information Institute \(cornell.edu\)](#)

¹¹ [Securities and Futures Ordinance](#) (cap 571)

¹² [Securities and Futures Act - Singapore Statutes Online \(agc.gov.sg\)](#).

¹³ [Securities and Futures \(Clearing Facilities\) Regulations 2013 - Singapore Statutes Online \(agc.gov.sg\)](#)

- (b) *if the money deposited with or paid to the approved clearing house is in the currency of a foreign country or territory, debentures of the government of that country or territory;*
- (c) *negotiable certificates of deposit;*
- (d) *money market funds”*

28. To ensure that these investments are eligible, the CCP must get the approval of the Authority for investing customers’ money, which needs to satisfy the following criteria:

- “(a) that the management of the investments made by the approved clearing house is consistent with the principles of preserving principal and maintaining sufficient liquidity to meet the obligations of customers of members of the approved clearing house;*
- (b) that prudential measures have been adopted to manage the risks in respect of the investment activities of the approved clearing house; and*
- (c) of any other matter which the Authority considers necessary for the sound management of the investments”*

3.3.5 Switzerland requirements

29. Switzerland has established its regulatory framework for CCPs’ investments through the Financial Market Infrastructures Ordinance (FMIO)¹⁴ and the Financial Market Infrastructure Act (FMIA)¹⁵.
30. Article 52(2) of the FMIA sets out that a CCP *“shall invest its financial resources solely in cash or in liquid financial instruments with a low market and credit risk.”*
31. Article 52(3) of the FMIO further adds that *“the investment strategy of the central counterparty must be in harmony with its risk management strategy. It must avoid concentration risks.”*

3.3.6 United Kingdom requirements

32. At the end of 2020, the United Kingdom introduced various regulations to transpose and sometimes modify the legal framework established by the European Union for the financial sector. Several amendments were done through The Over-the-Counter Derivatives, Central Counterparties and Trade Repositories Regulations 2020¹⁶ to establish a new domestic law, which includes CCPs’ governing rules. As for the

¹⁴ [FMIO SR 958.11 - Ordinance of 25 November 2015 on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading \(Financial Market Infrastructure Ordinance, FMIO\) \(admin.ch\)](#)

¹⁵ [FMIA SR 958.1 - Federal Act of 19 June 2015 on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading \(Financial Market Infrastructure Act, FinMIA\) \(admin.ch\)](#)

¹⁶ [The Over the Counter Derivatives, Central Counterparties and Trade Repositories \(Amendment, etc., and Transitional Provision\) \(EU Exit\) Regulations 2020 \(legislation.gov.uk\)](#)

European regulations on CCPs' investments (i.e. Article 47 of EMIR), the amendments made by the United Kingdom have not affected these provisions until now.

3.3.7 Australia requirements

33. In the case of Australia, various “Financial Stability Standards for Central Counterparties” are determined under section 827D (1) of the Australian Corporations Act of 2001. This section provides the Reserve Bank of Australia with the ability to establish standards “*for the purposes of ensuring that CS facility licensees conduct their affairs in a way that causes or promotes overall stability in the Australian financial system.*”
34. In particular, Standard 15 determines how a CCP should operate in order to maintain its investments safe:

“Standard 15: [...] A central counterparty should safeguard its own and its participants’ assets and minimise the risk of loss on and delay in access to these assets. A central counterparty’s investments should be in instruments with minimal credit, market and liquidity risks. [...]

15.4 A central counterparty’s investment strategy should be consistent with its overall risk management strategy and fully disclosed to its participants, and investments should be secured by, or be claims on, high-quality obligors. These investments should allow for quick liquidation with little, if any, adverse price effect.”

Question 1: Does the above section describe accurately the requirements on CCP investments outside the EU? Are there other jurisdictions that ESMA should consider to inform its analysis?

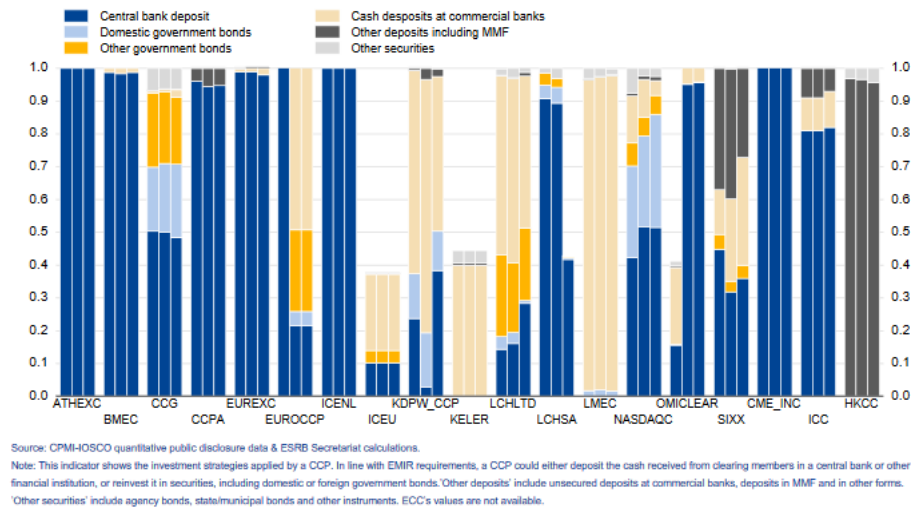
3.4 Investment practices of CCPs

35. In line with EMIR requirements, an EU CCP can either deposit the cash received from clearing members in a central bank or in another financial institution, or reinvest it in highly liquid debt instruments.
36. The ESRB Risk Dashboards¹⁷, based on CPMI-IOSCO quantitative public disclosure data, provide a quarterly breakdown of cash reinvestment policies of 19 CCPs worldwide, including 12 EU CCPs¹⁸.

¹⁷ [ESRB Risk dashboard](#), Section 8.10 Cash reinvestment policies, June 2021

¹⁸ Results for ECC are missing

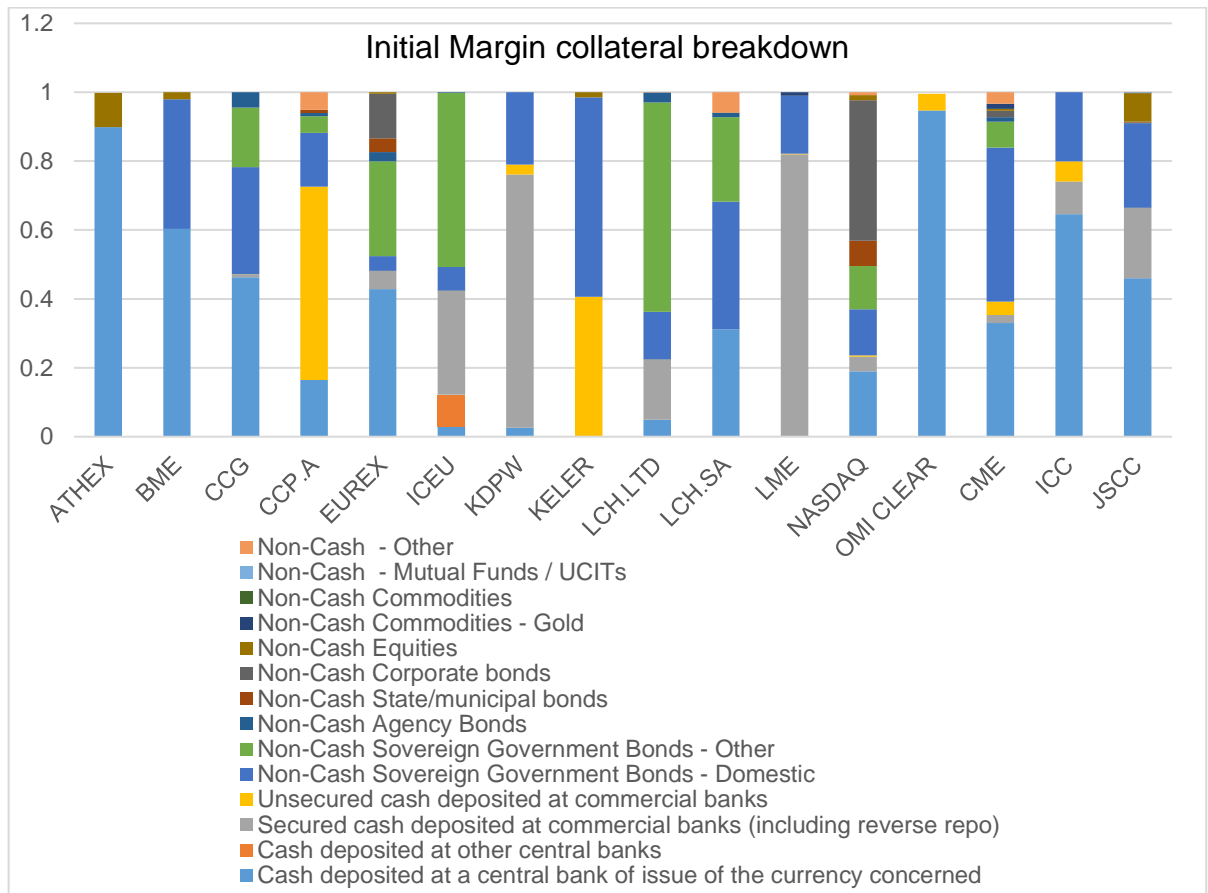
8.10 Cash reinvestment policies Breakdown info (last observation: Q4 2020)



Source: ESRB Risk Dashboard, 8.10 Cash reinvestment policies, June 2021

37. The results highlight that more than half of EU CCPs invest 90% of their financial resources in central bank deposits. Three EU CCPs use cash deposits at commercial banks as their main way of investing cash, while three EU CCPs also have recourse to domestic and other government bonds. No EU CCP invests more than 10% of its financial resources in other securities or other deposits.
38. With respect to non-EU CCPs (UK, Switzerland, USA, Hong-Kong) presented in the ESRB Risk Dashboard, their investment strategies are more diversified across the financial instruments at their disposal in their local jurisdiction.
39. The dashboard reflects discrepancies across jurisdictions with US CCPs massively investing their financial resources in central bank deposits, while UK CCPs split their investment strategy between central bank deposits, government bonds and to a large extent cash deposits at commercial banks. Only the Swiss CCP reported investing its financial resources as well in other deposits including MMFs (around a third), while this constituted the main investment strategy for one Asian CCP.
40. As expected under the EMIR requirements, the investments possibilities for collateral posted by clearing members to the CCP are more diversified. According to an ESRB Occasional Series Paper¹⁹, while the overwhelming majority of EU CCPs hold initial margin in cash (both in central and commercial banks) and government or agency bonds, a few have recourse to local bonds, corporate bonds and equities. This view was confirmed by ESMA's analysis of more recent CCP data.

¹⁹ ESRB Occasional Series Paper, [Indicators for the monitoring of central counterparties in the EU](#), March 2018



Source: Clarus Financial Technology, ESMA, September 2020

Question 2: Does the above section provide an accurate description of CCP practices regarding their investment and collateral policies?

4 Extension of the list of financial instruments for CCP investments

41. When considering a potential extension of the list of financial instruments accepted for CCP investments, a first step is to consider the current scope of instruments qualifying as *“highly liquid financial instruments with minimal market and credit risk”*.
42. The EU legislation in financial services has different definitions of highly liquid instruments or assets to identify collateral which can be easily liquidated at minimal risk.

4.1 Definitions of highly liquid financial instruments in the EU

4.1.1 EMIR collateral requirements

43. As highlighted previously, CCPs follow strict although less stringent requirements for the collateral they can accept from clearing members, than for the reinvestment of the cash they collect.
44. Under Article 46 of EMIR and Article 39 of the EMIR Delegated Regulation, CCPs are allowed to accept highly liquid collateral with minimal credit and market risk, as well as bank guarantees for NFCs and gold under certain conditions – and are therefore not limited to debt instruments.
45. CCPs can accept as collateral highly liquid financial instruments which fulfil the conditions for CCP investments, as well as transferable securities and money-market instruments which fulfil certain conditions outlined in Annex I but which do not restrict the type of issuer or guarantor to public entities, nor consider a limited average time to maturity. The linked investment risks are instead managed by the CCP by applying haircuts and concentration limits.
46. Nonetheless, some conditions to determine liquid financial instruments are similar to those for CCP investments, including denomination, transferability, marketability and price reliability.

4.1.2 Bank liquidity requirements

47. Beyond the PFMI and EMIR, the financial reforms following the global financial crisis have also sought to strengthen the regulation, supervision and risk management of banks, in particular by establishing global liquidity standards, including the liquidity coverage ratio (LCR).
48. The BCBS LCR is calculated by dividing a bank's stock of unencumbered High Quality Liquid Assets (HQLA) by its projected net cash outflows over a 30-day horizon in a stressed environment, while the application of a cap on inflows may apply as specified by regulators.
49. An ECB comparative study on collateral eligibility requirements²⁰ provides a succinct summary of the HQLA classification under the Capital Requirements Regulation²¹ (CRR). Level 1 assets are limited to a) cash, b) central bank reserves, c) marketable securities representing claims on, or guaranteed by, sovereigns, central banks, public sector entities or supranational institutions and satisfying certain conditions.
50. Level 2 assets comprise Level 2A assets and any Level 2B assets permitted by the supervisor. Level 2A assets are limited to a) marketable securities representing claims on, or guaranteed by, sovereigns, central banks, public sector entities or multilateral

²⁰ ECB [Collateral requirement study. Comparative study across specific frameworks](#), July 2013

²¹ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, [Consolidated version](#)

development banks that satisfy certain conditions; b) corporate debt securities (including commercial paper) and covered bonds that satisfy certain conditions. These are also subject to a 15% haircut.

51. Level 2B assets are limited to: (a) residential mortgage-backed securities that satisfy certain conditions, which are subject to a 25% haircut; (b) corporate debt securities (including commercial paper) that satisfy certain conditions, which are subject to a 50% haircut; and (c) common equity shares that satisfy certain conditions, which are subject to a 50% haircut.
52. The EU Delegated Regulation 2015/61²² supplementing CRR (hereafter referred to as the 'CRR Delegated Regulation') defines in further granularity which instruments qualify as liquid assets. Article 10 on Level 1 assets includes similar restrictions to the EMIR requirements on CCP investments on the issuer of debt instruments, which are mainly limited to central bank and government debt or assets guaranteed by them.
53. However, the CRR Delegated Regulation presents some variations with Annex II of the EMIR Delegated Regulation.
54. First, the CRR Delegated Regulation expands the list of public entities accepted to regional governments, local authorities or public sector entities provided that they are treated as exposures to the central government.
55. Second, the definition of accepted international organisations is slightly larger and includes the EU, the International Monetary Fund (IMF) and the Bank for International Settlements (BIS), which are currently not explicitly included in Annex II where the EFSF and ESM are cited.
56. Third, the CRR Delegated Regulation includes covered bonds as a Level 1 asset – under certain conditions including a haircut of at least 7% – which are not considered under the EMIR Delegated Regulation.
57. In addition, for certain assets to qualify as Level 1 assets, the CRR Delegated Regulation requires that they are assigned a credit assessment by a nominated external credit assessment institution (ECAI) of at least credit quality step 1, whereas EMIR encourages internal assessments to avoid overreliance on credit rating agencies.
58. Finally, the CRR Delegated Regulation does not include a maturity requirement on accepted debt instruments.

4.2 Policy discussion on instruments for CCP investments

4.2.1 Trade-offs in CCP investment strategies

59. CCPs receive collateral under the form of cash or highly liquid securities by their clearing members to fulfil their margin requirements. CCPs have to choose if they prefer to hold

²² COMMISSION DELEGATED REGULATION (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions, [Consolidated version](#)

the cash posted either as deposits in central or commercial bank accounts or to reinvest it in highly – though slightly less – liquid financial instruments.

60. Different factors play into CCP investment strategies and are subject to necessary trade-offs to address different risks, including liquidity, custodian and investment risks.
61. First, CCPs will normally seek to maintain the cash provided by members in the most liquid form possible to be able to immediately pay out margin calls or worse to absorb losses following the default of a clearing member.
62. Second, CCPs must also face custodian risks depending on how securely the cash is held. The most secure form to hold cash remains in central bank accounts, explaining why it is a very popular option among EU CCPs.
63. However, not all CCPs may have access to central bank accounts, either for regulatory reasons (due to added cost of obtaining a banking license or to the fact that the local central bank does not wish to take on CCP risk) or because the financial instruments cleared by the CCP are not denominated in the currency of the local central bank. While Variation Margin (VM) is generally paid in the currency of the financial instruments to avoid adding FX risk, CCPs typically accept Initial Margin (IM) payments in other currencies so that they can keep on clearing after their FX domestic market closes.
64. In both cases, CCPs wanting to hold on to the cash will have to deposit it in commercial bank accounts, either in a secured or unsecured manner, which exposes them to higher counterparty credit risk in case the commercial bank defaults.
65. In addition, depositing money at a bank account is not free and requires a fee, which can have more or less big impact depending on the current interest rate environment, especially for central bank accounts.
66. In such cases, where the deposits in commercial bank deposits appears less secure or where the CCP considers the fees paid for bank accounts to be too high (diminishing the available cash), the CCP may consider investing this cash into highly liquid instruments.

Question 3: Does the above section accurately describe the trade-offs faced by CCPs when developing their investments strategies? What other factors or trade-offs can influence CCP investment strategies?

4.2.2 Policy considerations on CCP investment requirements

67. In this context, the regulatory requirements on the type of financial instruments in which CCPs can reinvest their cash will have important implications on their investment strategies.
68. Expanding the list of financial instruments for CCP investments – or loosening the conditions attached to their qualification as highly liquid – requires careful assessment as it may increase the market and credit risk of the CCP, thereby weakening its (and the EU system as a whole) robustness and soundness.
69. However, in some cases, the diversification of investments can reduce risks, via the mitigation of collateral concentration or a reduction of the counterparty credit risk. For

example, diversifying accepted financial instruments in other currencies may provide safe investment alternatives from a risk management perspective rather than safe keeping of assets in commercial bank accounts, notably when access to central bank accounts is not possible.

70. The mandate provided under EMIR Refit potentially opens a vast review as ESMA is asked to consider an extension of all types of financial instruments which could be considered highly liquid with minimal market and credit risk and suitable for CCP investments.
71. ESMA believes that this would be both an extensive and repetitive task given the past work done to identify highly liquid instruments in the EU financial regulatory framework.
72. In this context, ESMA believes it is useful to frame the policy discussion in relation to CCP investments.
73. First, ESMA proposes to limit the review of potentially suitable financial instruments for CCP investments in line with the Principles for Financial Market Infrastructure (PFMI) to ensure consistency with international standards and avoid excessive cross-border regulatory divergence. In this context, ESMA suggests limiting its review to *“investments secured by or claims on high-quality obligators”* in line with Principle 16 of the PFMI.
74. On this basis, ESMA would restrict its analysis in this section to debt instruments and focus on the suitability of the conditions defining highly liquid financial instruments with minimal credit and market risk.

Question 4: Do you agree with ESMA’s premise that changes to the list of financial instruments for CCP investments should be in line with the PFMI?

75. Second, ESMA is of the view that any expansion of the list or loosening of its conditions defining *“highly liquid with limit credit and investment risk”* can only be justified if the benefits outweigh the identified risks.

Question 5: Do you agree with ESMA’s policy approach that benefits should outweigh risks to support a policy change?

4.2.3 Conditions defining high-liquid financial instruments bearing minimal credit and market risk

76. Furthermore, ESMA notes that, under the mandate of EMIR Refit, ESMA is required to consider a potential review of the *“list of financial instruments that are considered highly liquid with minimal market and credit risk, in accordance with Article 47”*, and not to review Article 47 itself.

77. ESMA believes it is therefore appropriate to analyse the cumulative conditions for debt instruments attached to be considered “*highly liquid financial instruments, bearing minimal credit and market risk*” as detailed in Annex II of the EMIR Delegated Regulation.

Question 6: Do you agree with ESMA’s approach to focus on the list of conditions to define highly liquid instruments bearing minimal credit and market risk? Do you believe it would be appropriate to align EMIR with other definitions of highly liquid instruments in the EU financial legislation, such as CRR?

78. Annex II lists a first condition (a) requesting that the financial instrument be issued or explicitly guaranteed by:
- (i) a government;
 - (ii) a central bank;
 - (iii) a multilateral development bank as listed under Section 4.2 of Part 1 of Annex VI to Directive 2006/48/EC;
 - (iv) the European Financial Stability Facility or the European Stability Mechanism where applicable.
79. ESMA notes that since the EMIR Delegated Regulation entered into force in 2013, the list of public entities covered in Annex II has not been modified and therefore may need to be updated to reflect the latest developments on the debt market, and the related credit and liquidity risks.
80. To address the economic and social challenges due to the COVID-19 pandemic, the EU has increased its debt issuance to finance emergency and recovery measures. In January 2021, the European Commission has issued a EUR 14 billion social bond under the EU SURE instrument to help protect jobs and people in work, an amount to be completed by a further EUR 35 billion throughout 2021. At the beginning of June, the European Commission announced its first funding plan for NextGenerationEU²³ and will raise on behalf of the EU around EUR 800 billion in current prices until 2026.
81. Both bond issuances backed by the EU have been largely oversubscribed reflecting a high degree of market demand and confidence as confirmed by the credit ratings of the EU. The EU is rated AAA/Aaa/AAA/AAA (outlook stable) by Fitch, Moody’s, DBRS and Scope and AA (outlook positive) by Standard & Poor’s.
82. In addition, the size of the planned bond issuance is expected to generate high levels of market depth and liquidity, as the borrowing amount for EU NextGen will amount to 5% of the EU GDP, indicating that these instruments bear minimal credit and market risk.
83. Moreover, expanding the list of public entities to the EU could also help support investor interest for EU bonds and bills by enabling other types of financial participants to enter this market.

²³ NextGenerationEU, Recovery plan for Europe, [EC website](#)

84. In line with other pieces of EU legislation, it may also be appropriate to expand the list of accepted public entities at the international level to increase the diversification of collateral risk at minimal market and credit risk. As outlined in section 4.1, the Capital Requirements Regulation (CRR) explicitly includes other international organisations, such as the International Monetary Fund (IMF) and the Bank for International Settlement (BIS).
85. At the local level, regional governments and local authorities issuing or guaranteeing financial instruments, may already be covered by the generic term of “government” under Annex II, as long as these instruments are backed by central governments. However, Article 115 of CRR stipulates this should only be possible in cases “*where there is no difference in risk between such exposures because of the specific revenue-raising powers of the former, and the existence of specific institutional arrangements the effect of which is to reduce their risk of default*”, while due consideration should also be given to the liquidity risks of local bonds which do not benefit from the same market depth as central governments.
86. Similarly, the definition of government debt diverges from the CRR which limits to the number of countries acting as an issuer or guarantor to EU Member States and third country which apply supervisory and regulatory arrangements at least equivalent to those applied in the Union as determined by an Implementing Act by the European Commission.
87. ESMA also notes that the sub-condition (iii) for “*a multilateral development bank as listed under Section 4.2 of Part 1 of Annex VI to Directive 2006/48/EC*” may need to be updated as the Directive in question has been repealed and split between CRD and CRR. Annex IV to CRR clarifies that provisions contained in Annex VI, Part I, points 19, 20 and 21 (i.e. included in Section 4.2) have to be read as references to Article 117 of CRR (paragraph (1) covers point 19, paragraph (2) covers point 20 and paragraph (3) covers point 21).
88. Article 117(2) of CRR provides a list of the entities to be considered as multilateral development banks, including amongst others the European Investment Bank (EIB) and the European Investment Fund (EIF). While ESMA notes that the link to Article 117(2) under CRR could be updated, the current list of multilateral development banks appears to be suitable.

Question 7: with regards to condition (a) on public entities outlined in Annex II:

- (i) Should the list of international organisations be expanded beyond the EFSF and the ESM to explicitly include the EU?
- (ii) Should it include other international organisations (IMF? BIS? Others?)?
- (iii) Do you agree with ESMA’s legal analysis that it is not necessary to explicitly include regional governments and local authorities as these should be covered by the generic term of government under condition (a)(i)? Should ESMA consider adding conditions similar to those outlined in Article 115 of the CRR?

- | |
|---|
| <p>(iv) Should ESMA consider limiting the list of governments and central banks in particular to those from third-countries deemed to have equivalent regulatory and supervisory arrangements?</p> <p>(v) Do you agree that the list of multilateral development bank listed under Article 177(2) of CRR is suitable?</p> |
|---|

89. As highlighted above, the list of accepted issuers and guarantors is currently restricted to public entities including governments, central banks, certain multilateral development banks, the ESM and the EFSF, due to lower counterparty credit risks and deep secondary markets.
90. The list however does not include debt issued or guaranteed by private entities, unlike highly liquid assets under CRR which also include covered bonds that satisfy certain conditions as Level 1 assets and certain corporate debt securities (including Commercial Paper) as Level 2A assets which are subject to a minimum mandatory 15% haircut under CRR.
91. However, ESMA notes that such derogations are not included in the Basel III framework as corporate debt securities typically do not have the same credit quality, market depth and liquidity as other debt instruments listed above, making them more subject to volatility and changes in liquidity conditions.
92. While certain aspects can be mitigated by concentration limits and haircuts, ESMA takes a conservative view to the potential benefits of such an extension and believes that an in-depth quantitative study would be necessary before considering expanding the list of eligible instruments to certain money-market instruments or corporate bonds.

<p>Question 8: Should ESMA consider expanding condition (a) to certain debt instruments issued or backed by private entities? If so, to which type of corporate debt securities (Commercial Paper, Certificates of Deposits, covered bonds, etc.)? Under what conditions? How would the benefits outweigh the added risks?</p>

93. Condition (b) focuses on the CCP's assessment to identify instruments with low credit and market risk and with reduced reliance on external opinions. The condition further specifies that the internal assessment of the CCP shall "*employ a defined and objective methodology that shall not fully rely on external opinions and that takes into consideration the risk arising from the establishment of the issuer in a particular country*".
94. EU CCPs have developed collateral management systems which include internal checks to manage the market and credit risks of the accepted collateral and the CCP's reinvestments, notably with regards to the risks resulting from the issuer of securities.

95. Certain best practices in the industry²⁴ for CCP credit risk management provide additional insights regarding the development of counterparty rating systems (usually 'scorecard models') and suitable early warning indicators (EWIs) to monitor credit risk including against external rating agency downgrades.
96. Some CCPs appear to have outsourced these functions within the same group or to third-party providers (in addition to external credit ratings) to avoid overreliance and potentially procyclical effects of rating corrections.
97. EMIR Q&A²⁵ 22 provides some additional guidance on the adequacy of collateral policies and procedures to monitor on an on-going basis liquidity, credit risk, and market risk. The Q&A recommends that CCPs develop risk indicators, ensure sufficient data coverage, develop and maintain governance processes on accepted collateral and review these policies regularly. ESMA notes however that the Q&A focuses mainly on collateral management policies and does not provide specific guidance for CCP investment policies, nor does it provide common rules or guidelines under EMIR as to how to evaluate or address reliance on external opinions.

Question 9: with regards to condition (b) on CCP internal assessments in Annex II:

- (i) What are, to your knowledge, the best practices used by CCPs to identify low credit and market risk?
- (ii) What are the safeguards put in place to avoid overreliance on external opinions, notably CRAs?
- (iii) In order to avoid supervisory divergence, do you deem necessary that ESMA issue further guidance on how NCAs should assess these provisions?

98. Condition (c) limits the average time to maturity of the CCP's portfolio to two years.
99. ESMA understands the average time to maturity to be generally calculated as the average remaining time to maturity for each financial debt instrument weighted by their percentage value in the CCP's portfolio.
100. In effect, rather than limiting the average time to maturity per debt instruments, the condition applies at CCP portfolio level, providing added flexibility whilst overall limiting credit risk.
101. ESMA notes that rules providing further guidance on the average time to maturity exist for MMFs in the CESR Guidelines²⁶ from May 2010, which, for example, differentiate between the calculation of the weighted average maturity and the weighted average life for MMFs.

²⁴ EACH, [Best practices in CCP credit risk](#), May 2021

²⁵ ESMA, [EMIR Q&A](#), September 2021

²⁶ CESR, [Guidelines on a common definition of European money market funds](#), May 2010

102. However, ESMA notes that the calculation methodology for CCP investments is not defined in the RTS and could be calculated a limited set of data points, which may provide a wrong image of the average time to maturity and hence of the risk of the CCP's portfolio.

Question 10: with regards to condition (c) on the average time to maturity, do you believe that this time period is appropriate? Should its calculation be further specified in the RTS?

103. ESMA notes that conditions (d), (e), (f) and (g) under Annex II are similar to those listed under Annex I on collateral requirements in the RTS of EMIR.
104. Condition (d) requires that the eligible financial instruments be denominated in a currency in which the CCP can demonstrate that it is able to manage the related risks or that it clears to avoid exposing the CCP to added currency risk.
105. Conditions (e) and (f) relate to the transferability and marketability of accepted financial instruments requiring them to be *“freely transferable and without any regulatory constraint or third-party claims that impair liquidation”* and to *“have an active outright sale or repurchase agreement market”* to ensure high levels of liquidity and collateral transformation even under liquidity stress.
106. Finally, condition (g) requires that reliable price data on these instruments are published on a regular basis to ensure sufficient levels of transparency and that information on these instruments is easily accessible.

Question 11: with regards to conditions (d), (e), (f) and (g) under Annex II, should these be amended?

5 Inclusion of MMFs

107. The mandate under Article 85(3a(e)) in EMIR Refit regarding a potential extension of the list of financial instruments for CCP investments makes a clear request on ESMA to consider the inclusion of one or more money market funds authorised in accordance with the EU Regulation on money market funds (EU) 2017/1131 (“MMFR”).
108. Money market funds (MMFs) are key intermediaries in the financial system. They provide two main economic functions to the financial system and real economy: they (i) provide short-term funding to issuers, mainly banks, corporations, and governments; and (ii) are primarily used as cash management vehicles by investors.
109. However, the market events following the COVID-19 lockdowns, and notably the liquidity strains observed on short-term funding markets, have again raised the issue of possible outstanding vulnerabilities in money market funds, despite the regulatory reforms following the global financial crisis, which may need to be addressed by a review of their regulatory framework.
110. ESMA launched in March 2021 a Consultation Report discussing the potential reforms of the EU MMF regulatory framework that could be envisaged, in light of the lessons learnt during the COVID-19 crisis in March 2020, and is currently reviewing the responses collected.
111. This section focuses solely on the suitability of MMFs for cash investments from the CCP perspective. While it considers the impact of potential regulatory changes on the appropriateness of MMFs for CCP investments, it does not cover the impact of the said potential reforms on MMFs, their investors or the broader financial system.

5.1 Current EU regulatory framework on Money Market Funds

5.1.1 EU MMFR

112. Since the global financial crisis in 2008, the EU adopted new rules in 2017 to increase the resilience of the MMF sector, transposing international guidance²⁷ into EU law.
113. The MMF Regulation applies to undertakings for collective investment in transferable securities (UCITS) authorised under Directive 2009/65/EC²⁸ or alternative investment funds (AIFs) under Directive 2011/61/EU²⁹, which invest in short-term assets and have distinct or cumulative objectives offering returns in line with money market rates or preserving the value of the investment.

²⁷ IOSCO, [Policy recommendations for Money Market Funds](#), 2012

²⁸ Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)(recast), [Consolidated version](#)

²⁹ Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, [Consolidated version](#)

114. The MMFR introduced rules on the composition of MMFs' portfolios in order to make MMFs more resilient and limit contagion to the rest of the financial sector. These include rules on eligible assets, maturities of assets, liquidity, diversification, and the credit quality of both issuers and money market instruments.
115. There are two broad categories of MMFs: standard MMFs (investing mainly in assets maturing within 6 months) and short-term MMFs (investing mainly in assets maturing within 120 days). The MMFR establishes three categories of short-term MMFs: 1) the Constant Net Asset Value (CNAV) funds which are required to invest 99.5% of their assets in public debt, reverse repo backed by public debt and cash 2) the Variable NAV (VNAV) funds which are allowed to let their NAV fluctuate and invest in less liquid assets (such as commercial paper and certificates of deposit), and 3) the Low Volatility NAV funds which act as a hybrid between both models as it allows funds to offer a stable NAV (as long as that the market NAV does not deviate from the dealing NAV by more than 20 bp), while investing in a broader range of instruments.
116. Most importantly, the MMF Regulation introduced daily and weekly liquidity requirements with a view to strengthening MMFs' ability to handle redemptions and mitigate procyclical sales by introducing buffers. LVNAV and CNAV funds are required to consider temporarily suspending or limiting redemptions or applying liquidity fees where weekly liquid assets fall below 30% of total assets and the fund experiences daily redemptions totalling more than 10% of total assets.

5.1.2 Impact of COVID-19 on MMF markets

117. The COVID-19 market turmoil in March and April 2020 tested again in real life conditions the resilience of the MMF sector.
118. In particular, a number of EU MMFs faced significant liquidity issues during the period of acute stress in March 2020 with large redemptions from investors on the liability side, and a severe deterioration of liquidity of money market instruments on the asset side.
119. As outlined in ESMA's recent consultation paper on the EU MMF Regulation³⁰, MMFs exposed to private markets (LVNAVs and VNAVs in the EU, Prime MMFs in the US) recorded very high outflows, while facing challenges to dispose of their assets due to the lack of liquidity in Commercial Paper (CP) and Certificate of Deposits (CD) markets.
120. The rapidly deteriorating situation required substantial intervention by central banks through purchases of CP on primary or secondary markets, funding facilities for banks to buy MMFs (US Fed), or by extending the list of eligible collateral to unsecured bank bonds (ECB). While no EU MMF had to use gates or fees to suspend redemptions, these events call for further reflection on the vulnerabilities in the MMF sector, as also outlined in ESMA's Report on Trends, Risks and Vulnerabilities³¹.

³⁰ ESMA Consultation Report, [EU Money Market Funds Regulation – legislative review](#), March 2021

³¹ ESMA Report on [Trends, Risks and Vulnerabilities](#), No1 2021

5.1.3 Potential review of the MMF regulatory framework

121. The COVID-19 events in Spring 2020 have acted like a live test of the resilience of the MMF sector and highlighted outstanding vulnerabilities which may require further regulatory and supervisory intervention.
122. In this context, ESMA has launched in March 2021 its Consultation Report discussing potential reforms of the EU MMF regulatory framework ahead of the legislative review planned in 2022 but also to build on the lessons learned from the events observed on the short-term funding market in March 2020.
123. The European Systemic Risk Board (ESRB) also outlined preliminary policy considerations³² to reform MMFs requirements to cater for the cross-sectoral dimension of such reforms given their importance for cash management purposes and short-term funding.
124. These policy discussions go well beyond the EU, as similar discussions have picked up at the international level, given similar episodes observed in the US. In November 2020, IOSCO issued a thematic note³³ analysing the March-April events and providing initial considerations. The Financial Stability Board (FSB) launched in June 2021 a consultation on Policy Proposals to Enhance Money Market Fund Resilience³⁴ and published its final Report in October 2021³⁵.
125. The overarching objectives of these reforms are to enhance the resilience of MMF markets to shocks, by enabling them to continue delivering on their key functions (funding and cash management), whilst decreasing the likelihood of investor runs and the need for central bank intervention.
126. The policy options for MMFs can be grouped as reforms impacting the asset-side – by reviewing the composition or concentration of asset holding or introducing capital buffers – or the liability side – by introducing swing pricing or similar measures or by delinking temporary suspensions, redemption gates and liquidity fees from the current specific thresholds. Measures on either side of the balance sheet are likely to impact the liquidity profile of a category of MMFs.
127. Finally, other broader measures are being discussed to increase the resilience and transparency of MMFs by greater supervisory prerogatives, reporting requirements and stress-testing.

³² ESRB, [Issues note on systemic vulnerabilities of and preliminary policy considerations to reform money market funds \(MMFs\)](#), July 2021

³³ IOSCO, [Money Market Funds during the March-April Episode](#), November 2020

³⁴ FSB, Consultation report, [Policy Proposals to Enhance Money Market Fund Resilience](#), June 2021

³⁵ FSB, Policy proposals to enhance money market fund resilience: Final report, October 2021

5.2 Impact on CCP Investments

5.2.1 The current exclusion of MMFs from the list of allowed investments for EU CCPs

128. Under the current version of Annex II of the EMIR Delegated Regulation, money market funds cannot qualify as possible investments as they are neither debt financial instruments nor issued or explicitly guaranteed by a government, a central bank, a multilateral development bank, the European Financial Stability Facility (EFSF) or the European Stability Mechanism (ESM).
129. At the time of the drafting of the RTS in 2012, MMFs were not allowed in the list of eligible financial instruments for CCP investments since the MMF market had only recently experienced serious liquidity issues in 2007-2008 and were not yet subject to higher harmonized regulatory standards. In effect, the EU did not have a harmonised regulatory framework for MMFs at the time, as the MMFR would only be adopted four years later.

5.2.2 Regulatory practices in other jurisdictions

130. As highlighted in section 3.3, US CFTC rules (Regulation 1.25) includes MMFs as permitted investments for clearing members and for CCPs. These permitted investments in MMFs are subject to terms and conditions listed under section (c)(5), including with respect to their authorisation, sponsorship, custody rules, valuation.
131. It notably states that “*a fund shall be legally obligated to redeem an interest and to make payment in satisfaction thereof by the business day following a redemption request*”, effectively banning any form of gates or fees on redemptions.
132. Following its review of “Rule 2a-7” which governs MMFs and came into effect in 2016, the SEC had required MMFs to retain the authority under defined conditions to impose liquidity fees or suspend participant redemptions. These provisions are mandatory for MMFs that invest primarily in corporate debt securities (“Prime MMF”), and the provisions may be voluntarily adopted by MMFs that invest primarily in U.S. government securities (“Government MMF”).
133. The CFTC therefore issued clarifying guidance under the form of the No-Action Relief Letter No. 16-68³⁶ stating that permissible investment in MMFs will not be allowed in Prime MMFs, and in Government MMFs which chose to be subject to liquidity fees or redemption restrictions.
134. As mentioned in section 3.3, other jurisdictions hosting important financial centres, such as Singapore or Switzerland, have also included MMFs as part of the list of eligible financial instruments for CCP investment. However, others, like the UK and Australia, take a more conservative approach to CCP eligible investments, similarly to the EU.

³⁶ <https://www.cftc.gov/csl/16-68/download>

5.2.3 Investment practices of non-EU CCPs in MMFs

135. As mentioned in section 3.4, the ESRB Risk Dashboard for Q2 2021 on the cash reinvestment practices of 19 CCPs across the world shows that, CCPs from Switzerland, USA or Hong Kong occasionally invest their financial resources in 'other deposits including MMF', with strong discrepancies across regions: <10% for US CCPs, around 40% for the Swiss CCP and almost all the investment strategy for the Hong Kong CCP.
136. Even if no detail is available on whether these investments are in MMFs or in other deposits, it appears that even where the regulation allows a more diversified investment strategy for CCPs, CCPs tend to opt for these investments only moderately.
137. Similarly, only a small minority of initial margin is posted by clearing members to non-EU CCPs under the form of MMFs, though it is currently possible under their local requirements (see graph in section 3.4).

Question 12: Do you agree with this conclusion? To what extent are MMFs currently used as collateral or CCP investments beyond the EU?

5.2.4 Policy considerations regarding the inclusion of MMFs within the current regulatory framework

138. A change in policy enabling CCP investment in MMFs – as for any extension of eligible investments – would provide EU CCPs with additional options to invest cash in non-cash collateral. This would help diversify its investment possibilities and help mitigate certain concentration and custodian risks as outlined in section 4.
139. Moreover, the popularity of investments in MMFs in certain jurisdictions can be explained by the fact that they are cost efficient and simple in use compared to having to set up a trading desk to invest directly in debt instruments.
140. In addition, expanding the list of CCP eligible investments could help level the playing field for EU CCPs competing with third-country CCPs and promote the use of EU UCITS and AIFs authorised as MMFs.
141. However, from a CCP perspective, the credit quality and liquidity of the investment it holds are paramount, as the CCP must be able to immediately transform the investment into cash, in order to respond to abrupt market moves and remain balanced at all times.
142. As Article 85(3)(e) in EMIR allows ESMA to include one or more MMFs authorised under the MMFR, ESMA could potentially identify a specific category of MMFs suitable for CCP investments which would respect the conditions in EMIR defining highly liquid CCP investments with minimal credit and market risk.
143. In other words, ESMA could consider allowing CCPs to invest in a specific sub-set of MMFs which are of the same credit quality and just as highly liquid as other highly liquid financial instruments eligible for CCP investments.

144. This approach would reiterate the importance of the highly liquid requirement for MMFs to be able to convert securities into cash easily to avoid importing liquidity stress into the CCP and ensure a minimum level playing field across investment possibilities depending on their risk profile.

Question 13: Do you agree with the premise that the assets held by eligible MMFs for CCP investment should at least meet the same criteria as for other financial instruments?

145. However, ESMA notes that it may not be straightforward to transpose this approach to MMFs in practice, especially as the conditions to define instruments highly liquid are cumulative, but also due to certain specificities of the short-term funding market.
146. For example, ESMA notes that condition (a) on public entities acting as a guarantor and issuer to those financial instruments may not always be practicable, as EU MMFs currently investing exclusively in EU sovereigns have disappeared in the past years given the low interest rate environment and may not constitute a viable option.
147. In addition, ESMA notes that other conditions may act as a barrier to including MMFs within the list of highly liquid financial instruments, in particular with regards to condition (e) on the free transferability of the financial instruments.
148. In practice, any rule impacting the liquidity profile of the funds (gates, fees, suspensions) would be seen as a regulatory constraint on the ability to redeem cash and therefore necessarily have an impact on the suitability of these assets for CCPs. In this context, only MMFs without rules potentially constraining the ability to redeem cash could be deemed eligible from a CCP perspective.
149. However, as these mechanisms were introduced to make these funds more resilient from the financial stability viewpoint (to avoid or limit runs), ESMA would highlight the tension between the regulatory objectives of strengthening MMF markets and safeguarding the resilience of CCPs.

Question 14: in your view, how could ESMA bridge the need for macroprudential tools for MMFs and the need for high quality and highly liquid collateral for CCPs?

150. In addition, ESMA notes that the ongoing policy discussions on MMF reforms touch very broad and fundamental dimensions of MMFs (such as composition, redemption gates, fees, buffers and others), as well as the way they are tailored to one type of MMF or applied across the sector.
151. This adds a significant level of uncertainty given the unpredictability of the policy outcome in the EU but also in other jurisdictions.
152. Therefore, it appears that, at this stage, a number of issues still remain open before allowing EU CCPs to be able to reinvest cash into MMFs. In particular, the issue about the immediate availability to the CCP of the cash invested in MMFs in case of need remains a concern. In addition, ESMA believes that other conditions may need further consideration such as condition (g) on the availability and reliability data on MMFs.

153. Under the current circumstances and given the expected future regulatory changes, ESMA does not believe that there is sufficient ground to recommend an extension of the list of financial instruments for CCP investments to MMFs at this stage.

Question 15: Do you agree with ESMA that it is not appropriate at this stage to decide on the potential eligibility of MMFs for CCP investments before policy discussions on MMFs at the international and EU levels are finalized?

6 Annex 1 – Legal provisions

Article 47 (EMIR)

Investment policy

1. A CCP shall invest its financial resources only in cash or in highly liquid financial instruments with minimal market and credit risk. A CCP's investments shall be capable of being liquidated rapidly with minimal adverse price effect.

2. The amount of capital, including retained earnings and reserves of a CCP which are not invested in accordance with paragraph 1, shall not be taken into account for the purposes of Article 16(2) or Article 45(4).

3. Financial instruments posted as margins or as default fund contributions shall, where available, be deposited with operators of securities settlement systems that ensure the full protection of those financial instruments. Alternatively, other highly secure arrangements with authorised financial institutions may be used.

4. Cash deposits of a CCP shall be performed through highly secure arrangements with authorised financial institutions or, alternatively, through the use of the standing deposit facilities of central banks or other comparable means provided for by central banks.

5. Where a CCP deposits assets with a third party, it shall ensure that the assets belonging to the clearing members are identifiable separately from the assets belonging to the CCP and from assets belonging to that third party by means of differently titled accounts on the books of the third party or any other equivalent measures that achieve the same level of protection. A CCP shall have prompt access to the financial instruments when required.

6. A CCP shall not invest its capital or the sums arising from the requirements laid down in Article 41, 42, 43 or 44 in its own securities or those of its parent undertaking or its subsidiary.

7. A CCP shall take into account its overall credit risk exposures to individual obligors in making its investment decisions and shall ensure that its overall risk exposure to any individual obligor remains within acceptable concentration limits.

8. In order to ensure consistent application of this Article, ESMA shall, after consulting EBA and the ESCB, develop draft regulatory technical standards specifying the financial instruments that can be considered highly liquid, bearing minimal credit and market risk as referred to in paragraph 1, the highly secured arrangements referred to in paragraphs 3 and 4 and the concentration limits referred to in paragraph 7.

ESMA shall submit those draft regulatory technical standards to the Commission by 30 September 2012.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010.

Article 43 (EMIR RTS)

Highly liquid financial instruments

For the purposes of Article 47(1) of Regulation (EU) No 648/2012, debt instruments can be considered highly liquid, bearing minimal credit and market risk if they are debt instruments meeting each of the conditions set out in Annex II.

ANNEX II (EMIR RTS)

Conditions applicable to highly liquid financial instruments

1. For the purposes of Article 47(1) of Regulation (EU) No 648/2012, financial instruments can be considered highly liquid financial instruments, bearing minimal credit and market risk if they are debt instruments meeting each of the following conditions:

- (a) they are issued or explicitly guaranteed by:
 - (i) a government;
 - (ii) a central bank;
 - (iii) a multilateral development bank as listed under Section 4.2 of Part 1 of Annex VI to Directive 2006/48/EC;
 - (iv) the European Financial Stability Facility or the European Stability Mechanism where applicable;
- (b) the CCP can demonstrate that they have low credit and market risk based upon an internal assessment by the CCP. In performing such assessment the CCP shall employ a defined and objective methodology that shall not fully rely on external opinions and that takes into consideration the risk arising from the establishment of the issuer in a particular country;
- (c) the average time-to-maturity of the CCP's portfolio does not exceed two years;
- (d) they are denominated in one of the following currencies:
 - (i) a currency the risks of which the CCP can demonstrate that it is able to manage; or
 - (ii) a currency in which the CCP clears transactions, in the limit of the collateral received in that currency;
- (e) they are freely transferable and without any regulatory constraint or third party claims that impair liquidation;

(f) they have an active outright sale or repurchase agreement market, with a diverse group of buyers and sellers, including in stressed conditions and to which the CCP has reliable access;

(g) reliable price data on these instruments are published on a regular basis.

2. For the purposes of Article 47(1) of Regulation (EU) No 648/2012, derivative contracts can also be considered highly liquid financial investments, bearing minimal credit and market risk if they are entered into for the purpose of:

(a) hedging the portfolio of a defaulted clearing member as part of the CCP's default management procedure; or

(b) hedging currency risk arising from its liquidity management framework established in accordance with Chapter VIII.

Where derivative contracts are used in such circumstances, their use shall be limited to derivative contracts in respect of which reliable price data is published on a regular basis and to the period of time necessary to reduce the credit and market risk to which the CCP is exposed.

The CCP's policy for the use of derivative contracts shall be approved by the board after having consulted the risk committee.

Article 85 (EMIR)

Reports and Reviews

[...]

3a. By 18 May 2020, ESMA shall submit a report to the Commission. That report shall assess:

[...]

(e) whether the list of financial instruments that are considered highly liquid with minimal market and credit risk, in accordance with Article 47, could be extended and whether that list could include one or more money market funds authorised in accordance with Regulation (EU) 2017/1131 of the European Parliament and of the Council ⁽¹⁾.

7 Annex 2 – Cost-Benefit Assessment

154. In order to assess the effects of the potential extension of the list of financial instruments considered highly liquid with minimal market and credit risk, in accordance with Article 47 of EMIR, and more specifically the extension to one or more money market funds authorised in accordance with MMFR, ESMA would like to receive data and other information on the possible costs or benefits of a potential extension of this list of financial instruments EU CCPs are allowed to invest in.

Question 16: What would be the costs and benefits of extending the list of financial instruments considered highly liquid with minimal market and credit risk, in the context of EU CCPs' investment policies?

Question 17: What would be the costs and benefits of extending the list of financial instruments to money market funds authorised in accordance with MMFR?

8 Annex 3 – Summary of questions

Question 1: Does the above section describe accurately the requirements on CCP investments outside the EU? Are there other jurisdictions that ESMA should consider to inform its analysis?

Question 2: Does the above section provide an accurate description of CCP practices regarding their investment and collateral policies?

Question 3: Does the above section accurately describe the trade-offs faced by CCPs when developing their investments strategies? What other factors or trade-offs can influence CCP investment strategies?

Question 4: Do you agree with ESMA's premise that changes to the list of financial instruments for CCP investments should be in line with the PFMI?

Question 5: Do you agree with ESMA's policy approach that benefits should outweigh risks to support a policy change?

Question 6: Do you agree with ESMA's approach to focus on the list of conditions to define highly liquid instruments bearing minimal credit and market risk? Do you believe it would be appropriate to align EMIR with other definitions of highly liquid instruments in the EU financial legislation, such as CRR?

Question 7: with regards to condition (a) on public entities outlined in Annex II:

- (i) Should the list of international organisations be expanded beyond the EFSF and the ESM to explicitly include the EU?
- (ii) Should it include other international organisations (IMF? BIS? Others?)?
- (iii) Do you agree with ESMA's legal analysis that it is not necessary to explicitly include regional governments and local authorities as these should be covered by the generic term of government under condition (a)(i)? Should ESMA consider adding conditions similar to those outlined in Article 115 of the CRR?
- (iv) Should ESMA consider limiting the list of governments and central banks in particular to those from third-countries deemed to have equivalent regulatory and supervisory arrangements?
- (v) Do you agree that the list of multilateral development bank listed under Article 177(2) of CRR is suitable?

Question 8: Should ESMA consider expanding condition (a) to certain debt instruments issued or backed by private entities? If so, to which type of corporate debt securities (Commercial Paper, Certificates of Deposits, covered bonds, etc.)? Under what conditions? How would the benefits outweigh the added risks?

Question 9: with regards to condition (b) on CCP internal assessments in Annex II:

(i) What are, to your knowledge, the best practices used by CCPs to identify low credit and market risk?

(ii) What are the safeguards put in place to avoid overreliance on external opinions, notably CRAs?

(iii) In order to avoid supervisory divergence, do you deem necessary that ESMA issue further guidance on how NCAs should assess these provisions?

Question 10: with regards to condition (c) on the average time to maturity, do you believe that this time period is appropriate? Should its calculation be further specified in the RTS?

Question 11: with regards to conditions (d), (e), (f) and (g) under Annex II, should these be amended?

Question 12: Do you agree with this conclusion? To what extent are MMFs currently used as collateral or CCP investments beyond the EU?

Question 13: Do you agree with the premise that the assets held by eligible MMFs for CCP investment should at least meet the same criteria as for other financial instruments?

Question 14: in your view, how could ESMA bridge the need for macroprudential tools for MMFs and the need for high quality and highly liquid collateral for CCPs?

Question 15: Do you agree with ESMA that it is not appropriate at this stage to decide on the potential eligibility of MMFs for CCP investments before policy discussions on MMFs at the international and EU levels are finalized?

Question 16: What would be the costs and benefits of extending the list of financial instruments considered highly liquid with minimal market and credit risk, in the context of EU CCPs' investment policies?

Question 17: What would be the costs and benefits of extending the list of financial instruments to money market funds authorised in accordance with MMFR?