European Securities and Markets Authority

ESMA REGULAR USE

The Chair

1 April 2022
ESMA91-372-2125

Ms Mairead McGuinness
Commissioner for Financial Services, Financial Stability and the Capital Markets Union
European Commission
Rue de la Loi / Wetstraat 200
1049 Brussels
Belgium

Ref: European Commission's targeted consultation on the review of the EU central clearing framework

Dear Commissioner McGuinness, *dear Mairead,*

I am writing to you with reference to the European Commission's targeted consultation on the review of the central clearing framework in the EU, which accompanied the publication of the Commission's decision to extend equivalence for UK CCPs until 30 June 2025.

The appendix attached to this letter constitutes ESMA's input to the consultation in the form of a high-level response. This document was discussed and prepared with the CCP Policy Committee (CCP PC) and the Post-Trading Standing Committee (PTSC) and approved by the Board of Supervisors on 30 March 2022.

In the first part of its response, ESMA outlines key considerations regarding the scope and implementation of the clearing obligation, in order to better incentivise clearing and to increase further the attractiveness of EU cleared markets. To that end, it leverages the various work streams and analyses recently conducted by ESMA on the clearing obligation. This includes ESMA's analysis[1] recommending the start of the clearing obligation for Pension Scheme Arrangements, the report[2] in support of facilitating the use of post trade risk reduction services provided that certain conditions are met to ensure the net risk is moved to CCPs, the final report and communication[3] issued to adapt the scope of the clearing obligation to the benchmark transition, as well as the discussion paper[4] reviewing the current clearing threshold coverage and framework.

ESMA also identifies a number of possible incentives for EU clearing participants to reduce their exposures to certain clearing services deemed of substantial systemic importance by

[1] ESMA recommends clearing obligation for pension funds to start in June 2023 (europa.eu)
[2] ESMA releases Report on post trade risk reduction services (europa.eu)
[3] ESMA issues statement on supervision of the clearing and derivative trading obligations following the benchmark transition (europa.eu)
[4] ESMA seeks input on EMIR clearing threshold framework (europa.eu)

ESMA. It builds on the public statement[5] issued by ESMA in December 2021 regarding the comprehensive assessment of substantially systemic third-country CCPs, where ESMA had recommended that the relevant EU and national authorities consider a number of risk-reducing and risk-mitigating measures to address the current exposure levels. ESMA sees merit in further considering these options following a thorough assessment of their risks and benefits to ensure that the costs of these options are not disproportionate to the expected benefits to the financial stability of the Union. Such analysis should also include how these requirements would compare to those over other non-systemic third country CCPs.

In the second part of its response, ESMA makes a number of targeted proposals to streamline the functioning of the EU CCP supervisory system and to address certain duplicative and inefficient supervisory processes, in order to ensure that the supervisory framework for EU CCPs remains agile and attractive for clearing participants.

Finally, ESMA notes that the Commission's consultation does not include proposals to mitigate the outstanding risks resulting from EU exposures to systemically important CCPs, in particular in cases of a CCP recovery and resolution. ESMA therefore makes a number of proposals to enhance ESMA's powers, in particular with regards to Tier 2 CCPs.

We remain at your disposal to further discuss and explore the different options outlined in our response to strengthen the central clearing framework in the EU.

Yours sincerely,

Verena Ross

cc.: Irene Tinagli MEP, Chair of the Committee on Economic and Monetary Affairs, European Parliament

Bruno Le Maire, President of the ECOFIN Council, Council of the European Union

Jeppe Tranholm-Mikkelsen, Secretary-General of the Council of the European Union

John Berrigan, Director-General, DG Financial Stability, Financial Services and Capital Markets Union, European Commission

Klaus Löber, Chair of the CCP Supervisory Committee

[5] ESMA, Public statement, ESMA concludes Tier 2 CCP assessment under Article 25(2c) of EMIR, 17 December 2021

ANNEX – ESMA HIGH-LEVEL RESPONSE

EC targeted consultation on the review of the central clearing framework in the EU

1. On 17 December 2021, ESMA published a statement accompanying the release of its comprehensive assessment of systemically important Third-Country Central Counterparties (Tier 2 CCPs). Three clearing services were identified as being of substantial systemic importance for the Union or one or more Member States, namely LCH Ltd SwapClear for euro and Polish zloty, ICE Clear Europe CDS and STIR services for euro products.

2. Based on a comprehensive analysis, the assessment concluded that, at this point in time, the costs of derecognising these clearing services would outweigh the benefits and therefore did not recommend to the European Commission that these services should not be recognised.

3. However, the assessment also identified important risks and vulnerabilities in connection with the continued recognition of these clearing services, in particular, in times of distress and in case of recovery or resolution of a Tier 2 CCP, as well as a number of risk-mitigating measures to address the current exposure levels to UK CCPs and resulting substantial systemic importance.

4. The Commission launched on 8 February 2022 a targeted public consultation on the review of the central clearing framework in the EU[6]. This paper identified a number of areas where it could be useful to provide ESMA's input.

5. The areas covered in ESMA's response, without aiming at going into detail on all the questions raised by the Commission, are: measures to incentivise EU clearing participants to reduce their exposures to UK CCPs and increase the attractiveness of the EU clearing ecosystem (section 1), but also measures to enhance the EU supervisory system (section 2) and to mitigate the outstanding risks remaining at UK CCPs (section 3).

[6] https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/2022-central-clearing-review-consultation-document_en.pdf

1 Measures to reduce exposures to T2 CCPs and increase the attractiveness of the EU clearing ecosystem

1.1 Clearing obligation

6. In the context of building domestic capacity and increasing the attractiveness of central clearing activities in the EU, an issue identified by the European Commission relates to a lack of liquidity in EU-based CCPs.

7. For markets where recourse to central clearing was historically low, the clearing mandates following the global financial crisis have been instrumental in driving these markets towards central clearing and, with them, appropriate levels of liquidity.

8. Successful clearing ecosystems typically have a large variety of participants with opposing directionality of portfolios. The expansion of the clearing obligation could be an interesting means, amongst others, to support the build-up of liquidity in Europe, by looking at the type of entities covered (1.1.1-2), the thresholds as from which the obligations apply (1.1.3), the scope of products and transactions covered (1.1.4), as well as other types of incentives for central clearing (1.1.5).

9. As a general remark, ESMA calls for caution with regards to proposals regarding the clearing obligation which, while they would decrease concentration of risks at UK CCPs, they should be done in a manner to avoid shifting this risk back to the uncleared space, effectively undoing the significant progress achieved since the G20 reforms.

1.1.1 Public entities

10. Article 1(4) of EMIR states that the Regulation does not apply to *"the members of the ESCB and other Member States' bodies performing similar functions and other Union public bodies charged with or intervening in the management of the public debt",* thereby excluding all Debt Management Offices (DMOs) which are typically strong users of interest rate derivatives to help manage their public debt.

11. Article 1(5) of EMIR further adds that, with the exception of the reporting obligation under Article 9, EMIR does not apply either to:

    (a) multilateral development banks, as listed under Section 4.2 of Part 1 of Annex VI to Directive 2006/48/EC;

    (b) public sector entities within the meaning of point (18) of Article 4 of Directive 2006/48/EC where they are owned by central governments and have explicit guarantee arrangements provided by central governments;

    (c) the European Financial Stability Facility and the European Stability Mechanism.

12. However, ESMA notes that certain types of public entities such as national or regional development banks already clear on a voluntary basis, supporting the idea that there are a number of benefits for public entities to clear (netting, prices, liquidity) and that further coordination across public entities to voluntarily clear in the EU could help building the required liquidity at EU CCPs.

13. Nonetheless, ESMA believes certain aspects would first need to be addressed, in order to make this a viable option, and thus that the voluntary nature should be preserved.

14. The modalities of the participation of public entities would need to be clarified. ESMA understands that there are diverging practices across Member States regarding the calculation of the exposures of public entities to EU CCPs and their contributions to the financial resources of the CCP. While these considerations are important for the resilience of the CCP and its members, the minimal credit risk of these entities should be recognised. The issue of ensuring a level playing field in the treatment of sovereign exposures across the Union should also be preserved.

15. ESMA stands ready to support further cooperation across NCAs in this domain.

1.1.2 PSAs

16. Another type of entity which is an important part of a balanced EU clearing ecosystem are Pension Scheme Arrangements ('PSAs' or pension funds). Currently, Article 89 of EMIR temporarily exempts PSAs from the clearing obligation until June 2022, and potentially until June 2023 at the latest depending on the European Commission's decision on this deadline. As a result, only 25% of their OTC interest rate derivates in notional terms are voluntarily cleared, while 71% of the overall OTC interest rate derivatives were cleared in Q4 2020[7].

17. In a recent letter[8] to the European Commission, ESMA finds that a mix of solutions is available to PSAs, including sponsored cleared repo models, such that there are less reasons to treat PSAs differently from other funds. ESMA also analysed the level of operational readiness of PSAs to clear and the various considerations to take into account to determine when the clearing obligation should start for PSAs. ESMA is thus of the view that the temporary exemption first introduced in 2012 should be stopped, and that sufficient time should be provided for PSAs and market participants before the clearing obligation starts applying to PSAs. Taking all this into account, ESMA has recommended a final one-year extension of the exemption to start applying the clearing obligation to PSAs on 19 June 2023.

18. This additional period should ensure that PSAs have sufficient time to finalise their clearing and collateral management arrangements in order to absorb the important additional cleared volume corresponding to PSAs' OTC interest rate derivative trading

[7] ESMA's ASR Report on the EU derivatives market: esma50-165-2001_emir_asr_derivatives_2021.pdf (europa.eu)
[8] https://www.esma.europa.eu/sites/default/files/library/esma70-451-110_letter_to_the_ec_-_clearing_obligation_for_psas.pdf

activity that is not yet voluntarily cleared. PSAs preparations for the clearing obligation will be able to take into account the recent and clear communications from the European Commission regarding the end of the equivalence decision for UK CCPs, such that the start of the clearing obligation for PSAs (coordinated with the changes being considered and developed by the Commission to direct the relevant clearing flows towards EU CCPs) would contribute to add further liquidity to EU CCPs as EU pension funds generally have a higher share of their activity in EEA currencies.

1.1.3 Clearing thresholds and scope of entities subject to the clearing obligation

19. In 2019, the EMIR Refit Review extended to financial counterparties the clearing threshold system that existed already for non-financial counterparties. The clearing thresholds help determine when certain counterparties would become subject to the clearing obligation, based on their aggregated OTC derivative position, i.e. capturing counterparties whose OTC derivative activity exceeds the clearing thresholds. This clearing threshold determination process is dependent on whether a derivative falls within the definition of an OTC derivative as set in Article 2 of EMIR.

20. The OTC derivative definition captures derivatives that are not executed on a regulated market or on a third-country market deemed equivalent under Article 2a. First of all, depending on whether a derivative falls within this definition or not, different requirements may apply to the counterparty entering into that derivative contract for that specific contract. Secondly, depending on whether a derivative falls within this definition or not, this derivative contract may fall in the scope of contracts counting towards the clearing thresholds, which can then trigger additional requirements when the counterparty starts exceeding the clearing thresholds.

21. ESMA issued in November 2021 a discussion paper[9] to collect stakeholder views on the effectiveness and proportionality of the EMIR clearing thresholds and whether the framework may need further fine-tuning in the future. It also asked input from stakeholders on the issue related to the definition of OTC derivatives and the calculation of the clearing thresholds, more specifically with regards to derivatives executed on third country markets not deemed equivalent, and in particular UK markets.

22. Under EMIR, without an implementing decision from the European Commission declaring a third country market equivalent to an EU regulated market, derivatives contracts traded on that third-country market are qualified as OTC. In the absence of such an equivalence decision, derivatives executed on UK Markets (which were EU regulated markets before Brexit), as from January 2021 are considered OTC. Consequently, these OTC contracts must be included in the calculation of counterparties' positions against the clearing thresholds (unless the hedging exemption applies in the case of non-financial counterparties), and this has an impact on entities

[9] https://www.esma.europa.eu/file/121880/download?token=z2SRupjh

that may suddenly become subject to the clearing obligation and possibly other collateral requirements. ESMA is aware of the challenges that some entities, energy firms in particular, may face as a result of this issue, as developed in the discussion paper. The issues raised by energy firms in the context of the discussion paper on the clearing thresholds from November 2021 are even more acute today in view of the recent developments and the significant energy price movements. These aspects are taken into account by ESMA in its work on the clearing thresholds, whereas this document focuses on the possible changes to Level 1 in the context of a review of EMIR.

23. ESMA is of the view that for determining under EMIR when bilateral margining and the clearing obligation [10] should apply, the distinction should move from the current approach of whether a derivative is OTC or not to the approach of whether a derivative is cleared or not. This change in the approach would address the systemic risk associated to OTC derivative contracts. ESMA is supportive of a broad implementation of clearing and therefore the fact that a derivative has been cleared by an authorised or recognised CCP (and thus the related risk being managed via the different safeguards provided through CCP clearing) should be recognised. This new approach (coordinated with the changes being considered and developed by the Commission to direct the relevant clearing flows towards EU CCPs) would contribute towards the objective of increasing cleared EU markets, as this new distinction further recognises the benefits of clearing.

24. While also recognised CCPs should be considered (i.e. these cleared trades would not count towards the clearing thresholds), for the non-recognised CCP activities, trades should count towards the clearing thresholds. This new approach would mean that derivatives executed on third-country markets and cleared via recognised CCPs would not count towards the clearing thresholds and there would thus no longer be a need for equivalence determinations under Article 2a of EMIR.

25. This different approach of cleared vs. non-cleared would thus be an improvement with regards to the calculation of the clearing thresholds. With the new approach, i.e. excluding from the calculation of the clearing thresholds the derivatives cleared at authorised or recognised CCPs, then an important part of the concerns raised in the discussion paper would be addressed.

26. In addition, it should be noted that this new approach would help ensure consistency with the approach for the initial margin requirements. The calculation of the thresholds for determining if and when the initial margin requirements would start to apply for a

[10] ESMA's proposal for changing the current distinction between OTC vs ETD to cleared vs non-cleared is focused on the criteria to determine when bilateral margining and the clearing obligation should apply. However, it is noted that a general application of this new approach could have broader implications that might be worth considering. For instance, in the allocation of the reporting obligation, i.e., when an FC concludes an OTC derivative with an NFC-, the FC should report on behalf of the latter to a TR.

given counterparty is also based on its level of OTC derivative activity, and in this case it only takes into account non-cleared contracts.

27. Such a change of approach would mechanically impact the current calculations of positions against the clearing thresholds. First of all, counterparties would need to start computing their positions in accordance with this new approach, but the consistency with the initial margin thresholds should in fact facilitate this exercise. And secondly, ESMA would need to review and possibly recalibrate the thresholds based on this new methodology.

28. Lastly, some consideration could be given regarding improvements to the notification framework when counterparties exceed the clearing thresholds. More specifically, there could be more centralisation at group level. This could be considered to enable more efficiency in the process for groups but also to help ensure readily access to this information to all relevant competent authorities.

1.1.4 Clearing obligation procedure

29. Further considerations could be given on the scope of financial instruments cleared (classes and currencies), but also regarding the type of activity (e.g. market making), whether a class is deemed of systemic importance (for instance EUR interest rate swaps), etc. whilst taking into account the attractiveness of the EU compared to other jurisdictions. In other words, a more granular procedure could be considered to take into account these additional aspects. More criteria could be considered and more parameters could be set via the clearing obligation procedure.

30. The clearing obligation procedure would also greatly benefit from a more agile and flexible framework in order to adapt the scope of the clearing obligation more quickly in view of market developments (a more agile and more flexible procedure would not necessarily mean more frequent updates, but more timely updates and would still consider the implementation implications for counterparties).

31. Currently, the perimeter of the clearing obligation is set in Level 1 and the actual classes in scope of the clearing obligation are set in Level 2. Modifications of the clearing obligation that would require a Level 1 change would need to wait until the next potential review of EMIR, which would typically take years, and changes to certain characteristics of the classes set in Level 2 need to go via the lengthy RTS approval process. ESMA is thus of the view that more criteria could be taken into account in the clearing obligation procedure and that some parameters being set could move from Level 1 to Level 2, and some others from Level 2 to the Public Register.

32. Moving some parameters from Level 1 to Level 2 would allow for quicker changes introduced while still ensuring that the Commission and the co-legislators keep control of these parameters as technical standards are subject to endorsement by the Commission and then the scrutiny period by the European Parliament and Council. Moving certain more technical parameters to properly identify or replace classes of

derivatives from Level 2 to the Public Register (as further explained below) would allow a quicker process to proceed with minor/technical adjustments to the scope of the clearing obligation, where ESMA could update the Public Register via ESMA decisions.

33. This way, the clearing obligation procedure could take into account more aspects, with some fundamental parameters set in Level 1, others more subject to change or to be amended to adapt to certain events would be set in Level 2 and finally the more technical ones could be set in the Public Register. This more granular and more agile clearing obligation procedure could contribute towards the overarching objective of mitigating systemic risk in a timely manner and help contribute to the attractiveness of EU markets.

34. Regarding the scope of OTC derivative classes subject to the clearing obligation, the bottom-up and top-down approaches already allow ESMA to determine if additional classes would be fit for the clearing obligation. However, as explained above, the determination process would benefit from a more agile process in order to proceed more quickly with adjustments to certain parameters or characteristics defining the classes in scope of the clearing obligation (the way stakeholders are consulted would remain the same, via a public consultation, and the ESRB would also be consulted). ESMA is thus of the view to consider moving some characteristics from Level 2 to the Public Register. It could be noted that EMIR Refit introduced a mechanism to suspend momentarily certain classes from the clearing obligation but not to add new ones or modify existing ones.

35. For example, when amending the clearing mandates to reflect the benchmark transition, i.e. moving away from classes referencing EONIA and LIBOR and replacing them gradually with classes referencing Risk Free Rates (RFR), several other jurisdictions have been able to rely on a leaner and more reactive process, which helps facilitating the transition to the RFR in a more effective manner. While the EU was one of the earliest jurisdictions to start this process, it has not yet imposed the clearing obligation for the classes referencing RFRs and has relied on an ESMA statement for deprioritising supervisory actions on the clearing obligation for LIBOR and EONIA referencing contracts, rates that should no longer be used as from 1 January 2022.

36. There could thus be a process where certain of the characteristics are defined via Level 2, such as the asset class or the currency, while some other characteristics defining a given class of OTC derivatives would be set via an ESMA decision reflected in the ESMA Public Register, such as the product type, the benchmark, the range of maturities, etc. This more agile process would help steer additional liquidity more quickly to EU CCPs while ensure the systemic risk of these new classes is also captured timelier by the clearing obligation.

37. Last but not least, in light of the strong interdependency between the EMIR clearing obligation and the MiFIR derivative trading obligation, any changes that may be considered and introduced for the clearing obligation procedure should also be considered and reflected in the procedure for the derivative trading obligation.

1.1.5 Exemptions for intra-group transactions

38. The EU Delegated Regulations on the clearing obligation and the bilateral margins originally introduced temporary exemptions for intragroup transactions with third-country group entities to facilitate centralised risk management-procedures for groups, while the relevant equivalence decisions are being assessed.

39. In view of the December 2021 letter from the EC, ESMA agrees that there is a need to review the intragroup exemption framework for the clearing obligation and bilateral margining in EMIR. Notably, the reliance on equivalence decisions under the current Article 13 should be reviewed.

40. In addition, it should be done in a way that incentivises central risk management of EUR and other Union currencies risk at EU CCPs, while also excluding exemptions for intragroup transactions with group entities in certain jurisdictions. More specifically, a possibility to achieve this might be through the addition of new conditions to be met in order to benefit from an intragroup exemption.

41. With regards to the first aspect, in order to benefit from an exemption, one of the conditions could be that EUR and Union currencies risks are centrally managed within the EEA, i.e. by an EEA group entity. In order to facilitate the implementation of such a change, it could be considered to have a centralised notification process by the EEA parent entity or the EEA group entity to all relevant competent authorities in the EEA such that all competent authorities would have a common set of information to assess these requests and conditions.

42. With regards to the second aspect, a condition could be introduced to ensure that the third country in which the group entity is established or authorised is not considered by the European Commission (in accordance with Directive (EU) 2015/849 of the European Parliament and of the Council), as having strategic deficiencies in its national anti-money laundering and counter financing of terrorism regime that poses significant threats to the financial system of the Union, nor has been subject to economic sanctions issued by the EU institutions.

1.1.6 Non-centrally cleared derivatives

43. In parallel to the clearing mandates, the post-financial crisis reforms also introduced risk mitigation techniques for OTC derivatives (including the mandatory exchange of bilateral margin) that are not centrally cleared, to ensure among other things that counterparties are appropriately collateralised against their market and credit risk exposures. The margin requirements for non-cleared OTC derivatives also have the benefit to act as a further incentive for the use of central clearing.

44. Following an internationally agreed calendar that is based on several thresholds representing different levels of activity in OTC derivatives, counterparties have gradually become subject to the mandatory exchange of initial margin. At this stage,

counterparties above the EUR 50 billion threshold are subject to the mandatory exchange of initial margin and from September 2022, counterparties above the EUR 8 billion threshold will become subject to the mandatory exchange of initial margin. This last phase should capture a larger number of buy-side firms, and thus bring a number of them towards more central clearing of their derivatives.

45. For non-financial counterparties, in order to know whether they are subject to the initial margin requirements, before checking whether they are above or below the relevant margin thresholds and in particular the 8 billion threshold, non-financial counterparties have first to pass the test of the clearing thresholds. Currently, when non-financial counterparties breach a clearing threshold in a given asset class, they become subject to the clearing obligation in that asset class. However, at the same time they become subject to the initial margin requirements for all their OTC derivatives, i.e. across all asset classes (when they also exceed the relevant margin threshold (50 billion, 8 billion mentioned above)).

46. ESMA is of the view that for non-financial counterparties, the logic of the clearing thresholds for the clearing obligation i.e. per asset class should also apply to the initial margin requirements. Similarly to the cleared vs. non-cleared approach discussed in section 1.1.3, the framework should also be risk driven. This means that non-financial counterparties should only become subject to the initial margining requirements, and thus introduce the necessary operational and collateral arrangements, for the asset classes where they have a significant activity in non-cleared derivatives, i.e. when they would exceed the clearing threshold calculated on the basis of their level of non-cleared derivative activity in a given asset class.

47. In addition, similarly to the clearing obligation where counterparties have a 4-month implementation period to put in place the necessary arrangements for complying with the clearing obligation, counterparties would benefit from having an equivalent implementation period for initial margin requirements when they first exceed the clearing thresholds.

1.2 Measures towards EU clearing participants

1.2.1 Capital treatments of Clearing Member exposures to CCPs

48. Section 9 of the Capital Requirements Regulation (CRR) provides for the prudential treatment of banks' exposures to CCPs. The CRR distinguishes between CCPs which are authorised or recognised in the EU ('qualifying CCPs') and CCPs which are not ('non-qualifying CCPs'). Exposures to the former benefit from preferential capital treatment as they do not fall under the Standardized Approach.

49. EMIR 2.2 introduced a difference between third-country CCPs which are deemed non-systemic (Tier 1) and those that are deemed systemic (Tier 2) for the Union and one or more of its Member States. Therefore, it was argued by some ESMA members that the existing differentiation in EMIR 2.2 regarding the systemic relevance of TC-CCPs could

be mirrored in the risk-weights applied to the exposures to TC-CCPs, in order to ensure that they appropriately account for the risks connected with the clearing activity. The analysis of the related risks to exposures to Tier 2 CCPs should encompass a thorough assessment of the risks, benefits and costs, including financial stability risks, to ensure that the costs of these options are not disproportionate to the expected benefits to the financial stability of the Union.

50. In addition, ESMA is mindful of how these can compare with similar requirements over other non-systemic TC-CCPs (Tier 1 CCPs). ESMA believes that the undesired effect of measures creating a shift of exposures away from Tier 2 CCPs on to other Tier 1 CCPs, where the EU has little control and oversight, should be avoided. Moreover, ESMA notes that this approach risks creating an unlevel playing field between Clearing Members established in the EU and Clearing Members established in third-countries, as the latter would not be subject to these prudential requirements but would still be able to serve EU clients.

51. An alternative option would be to consider whether the own funds requirements for exposures to CCPs set in CRR could be further fine-tuned to target clearing service-level exposures, rather than CCP-level exposures. If such an approach were to be pursued, the EU framework could consider targeting specific clearing services which have been determined as being of substantial systemic importance, in line with the ESMA public statement of 17 December 2021, by setting specific risk weights for these exposures by Clearing Members, addressing concentration risks towards these clearing services. However, this approach would have to be carefully finetuned bearing in mind that (i) in some cases, the netting set will require to use a wider service line than the one targeted, and (ii) the potential substitutability effects with other TC- and EU CCPs, hence the need for a consistent framework of measures, actively steering clearing activities towards EU CCPs.

52. ESMA notes that both options would require reviewing CRR.

1.2.2 Exposure reduction targets/caps

53. One related option suggested by some stakeholders for reducing excessive reliance on Tier 2 CCPs is to set targets or caps for reducing the level of exposures.

54. Should this option be pursued, it should be clarified that a proper framework to monitor the effective dependence of EU clearing participants on Tier 2 CCPs, and especially on substantially systemic clearing services which are critical for EU markets, would be essential to assess how these trends evolve in time and whether measures taken effectively reduce these exposures.

55. Moreover, to effectively serve as an exposure-reducing measure, if such targets were to be introduced they should be limited to the substantially systemic clearing services which are substitutable (to avoid negative impact for products which are only cleared at TC-CCPs) and should be set at the Clearing Member level to avoid a one size fits

all approach and ensure proportionality given the diversity of the EU Clearing Member landscape. Nevertheless, ESMA highlights the particular complexity when it comes to defining such targets and supervise their effective application.

56. While ESMA is not a prudential supervisor, ESMA notes that banking supervisors have experience in guiding the industry towards the reduction of positions that are deemed to be excessive as it was done for instance with respect to Non-Performing Loans (NPLs), where a consistent framework was developed to address the stock of NPLs as part of the supervisory dialogue through bank-specific supervisory expectations. Nonetheless, requiring the industry to reduce their exposures towards Tier 2 CCPs with a large variety of participants with an opposing directionality of portfolios could result in adverse financial stability effects as well if not done with sufficient caution.

57. Under a similar Tier 2+ exposure reducing approach, EU Clearing Members would be able to set their own exposure targets to reach the annual reduction milestones set by the prudential supervisors, in coordination with ESMA and the ESRB. This could be achieved through a two-step approach that would first aim for voluntary targets to provide the required flexibility for the industry, before considering whether mandatory milestones may be necessary to break the “first mover disadvantage” in building the required liquidity in EU CCPs.

58. In case of adoption of such measures, it would be important to maintain a certain degree of flexibility when defining and applying the targets to avoid disruptions in the provision of clearing services but also avoid putting EU Clearing Members at a competitive disadvantage. It would also be important to make sure that exposure reductions targets do not inadvertently affect smaller clearing participants disproportionately to larger clearing participants who more easily can shift a portion of their clearing needs to the EU. Therefore, the magnitude of these costs and their distribution should be analysed and evaluated, in order to inform whether this policy option is in the general interest of the Union.

1.2.3 Active clearing accounts

59. Under this approach, EU entities subject to the EMIR clearing obligation would open and maintain active clearing accounts in EU based CCPs pertaining to the clearing services that have been identified as being of substantial systemic importance by ESMA.

60. The aim is to incentivise counterparties who essentially clear these products to gradually shift their activities to EU CCPs, as maintaining two clearing accounts may become too expensive to be economically viable. For other participants with significant international activities, this should help maintain a level of activity also within the EU, ensuring a shift of the overall risks but also to help maintain a sufficient level of liquidity in the EU and reducing the CCP basis or price differential observed between certain Tier 2 CCPs and EU CCPs. To ensure a level-playing field, this should also apply to

third-country clearing members established in the EU with careful monitoring as to how transactions are booked.

61. However, ESMA believes the definition and parameters of what defines an active clearing account requires further analysis and specification in particular regarding the required amount of new clearing activity and open positions maintained at EU CCPs. These could be determined by quantitative thresholds for a proportion of the volumes/notional amount/frequency resulting from new trades over the total activity of the firms subject to the EMIR clearing obligation. Nevertheless, ESMA highlights the particular complexity when it comes to define such targets and supervise their effective application and notes the challenge in applying this to clients within omnibus accounts. In this context, ESMA believes it is important that a thorough assessment of risks, benefits and costs, including for smaller clearing participants, is performed as well.

62. While this approach could be introduced voluntarily at first, ESMA believes that this approach may be made mandatory if insufficient activity is shifted to the EU, following a thorough analysis of the potential adverse effects. It should also be noted that several ESMA members highlighted that this approach could be viable if combined with the one described above on capital requirements.

1.2.4 Treatment of EU clients' exposures to CCPs

63. ESMA understands that the proposals to introduce differentiated prudential treatments for Clearing Members' exposures to systemic CCPs or substantially systemic clearing services could be extended to clients under Article 305 CRR, under certain conditions related to segregated accounts and porting arrangements. However, ESMA notes that this would not be available for clients using the omnibus accounts and should be considered in a manner to avoid putting EU clearing members at a competitive disadvantage.

64. In addition, the present review of the EMIR framework and its interaction with CRR would be a good opportunity for the European Commission to take into account the findings and the recommendations expressed by the EBA and ESMA in 2017 in the report on the interaction of these two Regulations[11], and in particular with regards to clients' exposure.

65. However, other measures beyond capital treatments could affect the attractiveness of EU CCPs. For example, under the STS Regulation, the Delegated Regulation already specifies that EU MMFs can only benefit from a haircut exemption when entering into a reverse repo transaction with EU CCPs.

66. In a similar manner, different types of measures could be considered for certain types of clients with the objective to incentivise clearing. For example, this could be done with

[11] esas-2017-82_report_on_the_interaction_with_emir.pdf (europa.eu)

funds, such as UCITS by setting different counterparty exposure limits than the current limits, which would receive a more favourable treatment when clearing at EU CCPs. This approach would be consistent with the proposal in section 1.1.3 of the differentiation of cleared vs. non cleared rather than OTC vs. ETD. ESMA already published an opinion[12] on that topic, which could be taken into account in this context of the EMIR Review, when considering measures that further recognise the benefits of clearing. ESMA is of the view that such approaches could be developed to incentivise clearing at EU CCPs, without weakening the overall resilience of the EU financial system.

67. ESMA intends to further analyse different routes to incentivise EU clients to clear at EU CCPs, without introducing an obligation on EU clients to clear in the EU at this stage.

1.2.5 Post trade risk reduction services

68. ESMA has analysed the use of post trade risk reduction (PTRR) services and their interaction with the clearing obligation. This led to the publication of a report on this topic in November 2020. The Report investigated the different types of PTRR services and explained the purposes and functioning of such services. In addition, ESMA assessed if and to what extent an exemption from the clearing obligation for these services could discourage central clearing and could lead to a circumvention of the clearing obligation.

69. The report highlights that a limited and qualified exemption from the clearing obligation would further reduce not only risk in the market, but also its overall complexity. In other words, some regulatory measures (setting some conditions to benefit from an exemption and introducing an appropriate framework) could help foster and broaden the use of PTRR services while ensuring a broader use of central clearing.

70. Building from this report and its recommendations, ESMA is of the view that the review of EMIR could be the occasion to facilitate the use of PTRR services by a broader range of counterparties than currently, thanks to the use of more standardised financial products, and to redirect some of the resulting net risk to CCPs. In addition, PTRR services could be one of the tools to help migrate some of the risk currently booked in the UK or cleared in UK CCPs to EU entities and EU CCPs.

71. However, it should also be noted that the use of these PTRR services, and more broadly the use of post trade services, is becoming of systemic importance. For example, the report indicated that at the time, one of the providers, TriOptima, had processed and compressed to date 1,500 trillion of derivatives, around three times the size of the OTC derivative market.

[12] 2015-880_esma_opinion_on_impact_of_emir_on_ucits.pdf (europa.eu)

72. Furthermore, the report also highlighted that this is a highly concentrated area with only three main providers. The importance of these PTRR service providers in the value chain of market operators active in OTC derivatives is further highlighted by the fact that these providers are now part of bigger groups. Trioptima which has been part of CME, is now integrated in a post trade services joint venture with IHS Markit called OSTTRA. LSEG, the group of LCH SA and LCH Ltd, has announced acquiring Quantile. Capitalab is owned by BGC. All these aspects highlight the need to ensure that these services are provided in a fair and resilient manner, and thus having appropriate arrangements regarding governance, data management, operational risk, etc.

73. Like at the start of EMIR, when the EU Regulation ensured that EU CCPs were meeting high standards before the clearing obligation could be rolled out, and thus pushing large amounts of trade activity to CCPs, ESMA is of the view that the EU Regulation should also ensure PTRR service providers are operating within a set of high standards as EU Regulation is incentivising the use of these PTRR services (and with the recommendations from ESMA's report, would even facilitate and expand them).

74. A possible approach could be for EMIR to define the high-level framework that PTRR service providers should comply with and to task ESMA with the mandate for a Level 2 that would further define the applicable requirements. This approach would allow ESMA to take into account the findings from the current work being conducted by IOSCO on these PTRR services and providers.

75. Finally, appropriate supervisory arrangements should also be considered in view of the systemic importance of these providers.

1.2.6 FRANDT

76. The European Commission has adopted a Delegated Regulation on the fair, reasonable, non-discriminatory and transparent (FRANDT) terms for offering client clearing services that takes into account the technical advice developed by ESMA. This Delegated Regulation is still not applicable for a number of existing relationships, so it is a bit early to assess its impact on facilitating access to clearing.

77. However, in the context of the EMIR Review the European Commission could consider how to ensure that the requirements are complied with in a consistent manner and how to increase transparency for market participants. For instance, in the US the total margin held by FCMs is published by the CFTC, and such that similar measures could be envisaged.

1.3 Measures towards EU CCPs

1.3.1 Payment/settlement arrangements for central clearing

78. A recurring concern expressed by some clearing participants relates to the fact that EUR CCPs' margin calls after the closing time of TARGET2 require clearing members to pay these margin calls in non-euro currencies (in practice USD) as EUR payments cannot be processed after the closing time of TARGET2 (6pm CET).

79. However, it should be noted that following the 6pm closing time, TARGET2 reopens for ancillary system settlement at 7:30 pm with value D+1. Any CCP operation may then take place in real-time with D+1 value as long as this CCP makes use of the existing TARGET2 settlement models for ancillary systems.

80. ESMA believes that further consideration is necessary to assess whether extending the functioning of the TARGET2 system, considering the existing options available to CCPs, could help reduce the dependence of clearing members using EU CCPs on USD liquidity, and improve the attractiveness of EU CCPs (rather than having a direct impact to reduce exposures to Tier 2 CCPs).

81. ESMA notes that in November 2022 TARGET and T2S are planned to be integrated with a harmonised interface known as the Eurosystem single market infrastructure gateway (ESMIG) with common reference data and earlier opening hours, which could already address part of the issue at hand considering that the gap between the last valuation and the re-opening of TARGET2 will be considerably smaller.

82. It is however too early to assess whether this new arrangement will solve all of the issues identified by the industry as a limitation to their competitiveness particularly with respect to their Tier 2 CCPs competitors. In that respect, ESMA believes it is essential to engage in a continued dialogue with EU central banks and market participants to understand how they assess the effectiveness of the new arrangement and which implications it has on the attractiveness of EU CCPs.

83. As a final point, ESMA is not aware at this stage of similar concerns existing with regards to other Union currencies.

1.3.2 Funding and liquidity management conditions

84. The European Commission has also noted recurring proposals to expand access of EU CCPs to central bank accounts, and in particular, to the ECB. While such a decision falls within the central banks' discretion, ESMA notes that such accounts could have potential beneficial effects not only on the liquidity of the CCPs, but also how CCPs manage risks related to their investment and collateral policies, depending on the type of central bank access (intraday/overnight deposit account, intraday liquidity, overnight liquidity).

85. While ESMA notes that EMIR enables Member States to introduce additional requirements on to CCPs such banking licenses, providing access to standing central bank facilities, ESMA finds such additional requirements to be duplicative and costly, while not being conducive to reducing risks on top of applicable requirements outlined in EMIR and CCP RRR nor being applied consistently across Member States, potentially creating an unlevel playing field13.

86. ESMA finds that the extension of central bank facilities to all EU CCPs (with or without banking license) is worth exploring, especially as there are examples in other jurisdictions (see the Tier 2 CCPs) where the banking licence is not necessary.

2 Measures to streamline EU supervision

87. The unique set up of the CCP Supervisory Committee (CCP SC) developed under EMIR 2.2 bringing together the NCAs supervising EU CCPs with a Chair and two Independent Members in this first year of operation has improved the depth of cooperation between NCAs and ESMA, as well as between NCAs, providing for an increased level of trust among NCAs and fostering convergence in the day-to-day supervisory practice.

88. A number of NCAs suggested that there is value in the EMIR college arrangements due to its wider composition (with amongst others representatives of trading venues, central banks of issues, NCAs of Clearing Members) bringing different perspectives and interests in the discussions on college level. It has then to be tested as to what extent these benefits are achieved at the expense of added complexity.

89. The current supervisory framework already provides the EU with a strong capacity to deal with a potential increase in cross-border risks that would arise from potentially greater amounts of clearing in the EU.

90. Nonetheless, the interweaving of national, EU, and combined competences and powers has resulted in sometimes duplicative and unnecessarily burdensome supervisory processes which could benefit from further streamlining.

91. The current discrepancy in the efficiency of the legislative and sometimes supervisory framework between the EU and the UK creates a competitive disadvantage for EU CCPs compared to UK CCPs, as the UK supervisory system is simpler and therefore more reactive.

92. To increase the attractiveness of EU CCPs, the below section makes a number of proposals to rationalise certain supervisory processes under EMIR, in order to deliver more consistent and predictable outcomes for the stakeholders and for NCAs, notably

[13] IMF Country Report No.18/227, Euro Area Policies: Financial Sector Assessment Program-Technical Note-Supervision and Oversight of Central Counterparties and Central Securities Depositories, July 2018

regarding the launch of new clearing services and products, without reviewing the architecture of EU CCP supervision.

93. The option of improving the current supervisory structure was considered preferable by the majority of ESMA members to the other options indicated in the consultation document. In particular, only few ESMA members supported to concentrate the supervision of 'super-systemic' EU CCPs or of systemic activities performed by EU CCPs at ESMA.

2.1.1 Shortening timelines

94. ESMA notes that recurrent concerns have been expressed with regards to the length of certain approval processes. However, under EMIR 2.2, ESMA only has 20 working days to review certain NCA decisions such as extension of services and 50 working days to review significant changes to risk models and parameters.

95. To further streamline the process without diminishing the quality of the review, one option would be to introduce a limited delegation from the Board of Supervisors (BoS) to the CCP SC for non-controversial items or a non-objection procedure for the BoS approval which would expire after a given number of working days.

96. Nonetheless, ESMA notes that the length of the review for authorisation and extension of services by NCAs following completeness is six months, and could be reasonably shortened to ensure a more expedient process and a more competitive time to market for new clearing services and products. It should also be clarified that the timing for declaring completeness should not be extended indefinitely and the entire process from the first submission by the CCP to the final decision should be set at a reasonable timeframe. As for other pieces of EU legislation, ESMA believes that deadlines could be introduced regarding the length of the completeness assessments. Certain authorities also suggested the possibility for the NCA to request additional time in exceptional circumstances.

97. Another possibility would be to identify changes in activities or models for which a fast-track procedure could be envisaged, as is currently the case under Aritcle 49(1e) of EMIR to speed up the validation process of risk model changes. While maintaining ex-ante authorisation for more complex cases, it should be coupled with the ability of ESMA to conduct ex-post checks of the implementation by the CCP.

2.1.2 Streamlining CCP SC and college processes

98. EMIR 2.2 also requires both the CCP SC and the relevant EMIR college to prepare Opinions on the same NCA decisions under Articles 14, 15, 30 to 32, 35, and 54 of EMIR. This, while justified by the different compositions of the CCP SC and of the college, has resulted in duplicative practices and sometimes lengthy processes, in particular in the case of the extension of clearing services under Article 15 where shorter time to market is relevant from a competitiveness perspective.

99. ESMA believes it is important to streamline the processes ensuring that all the authorities are efficiently consulted within a set timeframe (as outlined in section 2.1.1). For example, certain procedures could be fast-tracked to the CCP SC, unless the college intends to depart from the ESMA/CCP SC Opinion. The EC may also wish to simplify the voting procedures at the level of the college and the CCP SC to give greater effectiveness to their Opinions.

2.1.3 Ensuring consistency across EMIR supervisory processes

100. EMIR 2.2 has created different supervisory processes to assess compliance with EMIR requirements by EU CCPs. Currently, certain NCA decisions are reviewed by the CCP SC[14], while some are jointly validated by ESMA and the NCA (Article 49) or complemented by Opinions (issued on the same subject) by the college. Other decisions remain solely in the hands of the NCA and are only discussed in the context of colleges, hence creating a complex, inconsistent and sometimes duplicative, system resulting in long procedures and possible uncertainties regarding the expected outcome of supervisory processes.

101. In addition, ESMA notes that when the CCP SC issues an Opinion, the relevant NCA is only required to explain why it has not decided to follow the view of the CCP SC. However, an NCA decision regarding the authorisation of a CCP can be overturned by the college should all its members unanimously adopt an Opinion against the NCA decision to authorise the CCP or be referred to ESMA for settlement dispute if a majority of two-thirds of the college decides to refer the matter to ESMA in accordance with Article 19 of the ESMA Regulation.

102. After one year of operation of the CCP SC, ESMA believes that further reflection as to whether the current split of supervisory processes per type of EMIR requirement is appropriate may be beneficial.

103. It seems it would make sense, given the amount of resources involved (the CCP SC and ESMA Board and the College), to ensure that the outcome of the decisions (and in particular ESMA's Opinion) is duly taken into account. An alternative option could be to revert to mechanisms such as those indicated in Article 17 or Article 19 of ESMA founding Regulation.

2.1.4 Supervisory priorities and implementing powers

104. In order to further enhance supervisory convergence in the EU, the CCP SC should be able to set supervisory priorities mirroring what is already foreseen under

[14] OTC open access requests (Articles 7-8), authorisation (Article 14), extension of services (Article 15), record keeping (Article 29), assessment of holdings and acquisitions (Articles 30-32), conflicts of interest (Article 33), outsourcing (Article 35), conduct of business (Article 36) and interoperability (Article 54) under EMIR

Article 29a of the ESMA Regulation. These priorities would be discussed and agreed within the CCP SC and help develop a more long-term view of priorities for EU CCP supervision.

105. In addition, ESMA would find it helpful for the CCP SC to be mandated with certain limited regulatory powers, such as the power to draft Implementing Technical Standards (ITS) to regulate ex ante certain matters to ensure convergence in addition to the possibility to issue soft law instruments such as guidelines and recommendations.

106. ESMA believes such changes are necessary for the EU regulatory and supervisory framework to maintain a certain level of flexibility, especially when compared to other jurisdictions.

3 Measures to mitigate remaining risks at Tier 2 CCPs

107. In its assessment of substantially systemic TC-CCPs, ESMA identified several scenarios in which the two Tier 2 CCPs established in the UK may potentially pose a financial stability risk to the EU or individual Member States, through the provision of certain clearing services to EU entities and markets in certain EU currency denominated products.

108. Furthermore, ESMA found that the insufficient supervisory powers, particularly in crisis events and including in the context of a Tier 2 CCP recovery or resolution, may hamper EU authorities' access to timely information and the possibility to intervene effectively in order to manage financial stability risks for the EU or individual Member States.

109. In addition to reducing EU exposures toward UK CCPs, ESMA believes that the CCP SC should be better armed to deal with the related risks, in particular for crisis scenarios.

3.1 Powers over Tier 2 and links to CCP RR

110. Regarding equivalence, the equivalence assessment should be extended to CCP RRR, possibly considering which provisions should apply and whether comparable compliance should be extended to CCP RRR.

111. Regarding recovery, ESMA should be granted an approval power in respect of the recovery plans for Tier 2 CCPs, in order to evaluate whether there is a need to limit potential negative impacts on EU market participants and EU financial stability.

112. Regarding resolution, ESMA should be consulted by relevant third country authorities before the validation of the resolution plan of a Tier 2 CCP. ESMA should also be consulted before any discretionary measures are taken that could potentially have adverse impacts on an EU market participant and, potentially, on EU financial

stability (such as a decision to restrict, suspend or terminate access of an EU bank to a third country CCP that is under resolution).

113. Finally, ESMA should be legally empowered to sign memoranda of understanding dealing with recovery and resolution of T2 CCPs, in order to enhance cooperation with UK authorities on CCP in crisis situations.

3.2 Comparable compliance

114. ESMA sees merit in revising the mechanism of comparable compliance as presently envisaged in order to cater for degree of systemic importance of the Tier 2 CCP. It should also be clarified that the granting of comparable compliance to a Tier 2 CCP does not limit or void ESMA's supervisory and enforcement powers over the Tier 2 CCP.

3.3 Other issues for all TC-CCPs

115. Regarding all recognition procedures, ESMA believes it is important to clarify that recognition can also be done at clearing service level (rather than CCP-level) under strict conditions from a risk management perspective (not only for derecognition as is currently the case) and to clarify what constitutes an extension or reduction of clearing services in the Union which would trigger a review of recognition.

116. To enable ESMA to properly monitor all TC-CCPs, ESMA should be empowered to request/review data on a periodic basis (rather than on ad hoc basis) and to develop an ITS to specify the data to be received from TC-CCPs. ESMA should be empowered to request information from EU clearing members (and if identified, clients) when necessary to monitor the potential risks related to the TC-CCP for the Union.

117. Finally, it should be clarified that, if the TC-CCP does not provide the information requested or refuses to pay the required fees within a given timeframe, this would be a motive to withdraw recognition depending on the seriousness of the failure and the remedial action.