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Paris, 22 March 2022

BANQUE DE FRANCE

ACPR and Banque de France response to the European Commission targeted consultation on the review of the central clearing framework in the EU

The Banque de France and the ACPR welcome the opportunity to respond to this targeted consultation and praise the work that has been done by the European Commission to provide an extensive reflection on areas where the central clearing framework could be revised and enhanced. We strongly support the objectives of this consultation.

We consider that the consultation paper is comprehensive enough in terms of potential measures proposed to achieve these objectives and contains a pragmatic approach allowing the relevant stakeholders to provide suggestions on how these measures could be implemented, while considering potential limits and risks.

Given the broad nature of the consultation paper, our response has focused on our main areas of competence. We deem that micro-prudential tools combined with exposures reduction targets should be implemented as soon as possible, in order to start the process of rebalancing the exposures towards EU CCPs.

We are of the opinion that a number of other measures such as the requirement for EU participants to hold an active account in an EU CCP, the extension of the clearing obligation to new products and an early adoption of the clearing obligation for pension funds could be implemented without particular obstacles. We also think that measures such as the obligation to fulfil the clearing obligation in an EU CCP or the introduction of a “swap dealer” status should be considered carefully.

Finally, we have provided our views on a proportionate approach to enhance the supervisory influence of European authorities (ESMA, Central Bank of Issue, EMIR Colleges, National Competent Authorities) on the supervision of systemic EU CCPs. This includes measures such as strengthening EMIR College opinions notably for projects with potential cross-border impacts; strengthening the involvement of the central banks of issue in the adequate supervision of CCPs; adjusting the role of ESMA, whether inside or outside Supervisory Colleges, as well as enhancing the representativeness of NCAs in the ESMA decision-making process.

This Banque de France and ACPR’s response is intended for publication.

OBSERVATIONS ON SELECTED QUESTIONS

1. <u>Scope of clearing participants and products cleared</u>

a) Clearing obligation for Pension scheme arrangements (PSAs)

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

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

PSAs are currently exempted from the clearing obligation. Reconsidering this exemption and thus imposing the clearing obligation to PSAs would be the most efficient way to increase the use of central clearing by these entities, and in turn increase the EU liquidity pool and reduce the costs of clearing in the EU.

Indeed, newly developed technical solutions such as sponsored accesses exist to make possible for pension funds to facilitate access to CCPs while catering for the payment of variation margin calls, included in stressed periods.

More precise guidance in level 1 or level 2 texts may be considered to ensure convergence in direct and sponsored access model practices, in order to improve their clarity for end-users while providing adequate safeguards.

Considering the current need to develop the EU clearing pool, we would favour an early adoption of the clearing obligation for pension funds from June 2022.

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

The Banque de France and the ACPR do not provide observations on this point.

c) Encourage clearing by public entities

General remarks – relate to:

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

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

Question 15. Which public entities should centrally clear in your opinion? Why?

Question 17. Which public entities should not centrally clear in your opinion? Why?

Imposing central clearing to public entities may not be in line with the mandate of public institutions acting for the general interest and supporting financial stability, which may require confidentiality. Central clearing for these public entities should remain voluntary. We are therefore of the opinion that the exemption as per the Art 1(4) of EMIR must be maintained and both clearing and reporting obligations should not be applied to (a) the members of the ESCB; (b) other Member States' bodies performing similar functions; and (c) other Union public bodies charged with or intervening in the management of public debt. Central clearing should therefore remain voluntary for these institutions.

This is in line with the ESCB's response to the European Commission's consultation on the review of the European Market Infrastructure Regulation (EMIR) of 2015, where it was also noted that the exemption takes into account the specific nature of central bank transactions that are undertaken in order to fulfil their statutory tasks, having due regard to the guarantees of central bank independence set out by Article 130 of the Treaty on the Functioning of the European Union (or other equivalent provisions under national law). In this respect, it should be recalled that central banks need to perform their tasks in an effective manner requiring the ability to enter into transactions without having to disclose the details of each of these transactions publicly.

d) Broaden the product scope of the clearing obligation

General remarks – relate to:

Question 2. Could additional products be subject to the clearing obligation?

Question 3. Does EMIR allow enough products to be subject to the clearing obligation?

With the overarching objective of reducing systemic risk, the European Market Infrastructure Regulation (EMIR) introduced the obligation to clear certain classes of OTC derivatives in CCPs that have been authorised (for European CCPs) or recognised (for third-country CCPs) under the EMIR framework, resulting in an increase of the clearing activity worldwide for the asset classes concerned.

The Banque de France and the ACPR think that an extension of the clearing obligation to additional asset classes and products would increase the overall demand for central clearing with consequent positive effect on CCPs' activity. Indeed, the increase of demand for central clearing in markets classes subject to the obligation may also lead to a rise in the demand in other asset classes, by increasing of cross-margining and cross-currencies netting opportunities. This may thus help the creation of pools of liquidity in a wide range of products and be beneficial to the overall system. However, it should be noted that the increase of the activity may also take place outside the EU and may raise the level of EU participants' exposures to non-EU CCPs, notably for their activity in EUR-denominated products. Therefore, we think that an extension of the clearing obligation should be combined with exposures reduction measures and targets to achieve both the objectives of strengthening the clearing activity in the EU and reduce dependence to third-country CCPs.

There are currently 19 classes of interest rate OTC derivatives denominated in EUR, GBP, JPY, NOK, PLN, SEK and USD and two classes of credit OTC derivatives denominated in EUR that are required to be centrally cleared with authorised or recognised CCPs. These asset classes were identified considering criteria such as: (i) the degree of standardisation of a product's contractual terms and operational processes; (ii) the nature, depth and liquidity of the market for the product in question; and (iii) the availability of fair, reliable and generally accepted pricing sources.

As the clearing activity landscape has changed and significantly grown since then, there may be scope to extend the obligation to other assets classes of derivatives. In our opinion, the extension should concern primarily the segments that were deemed as substantially systemic important in the context of the Art. 25(2c) of EMIR procedure, notably EUR-denominated interest rates derivatives and single names CDSs that are not currently covered by the clearing obligation. The extension should then also be considered for interest rates derivatives denominated in other currencies not currently covered by the obligation, even where volumes are currently low, and which clearing would facilitate the creation of pools of liquidity and increase the possibilities in terms of cross-currency netting.

For instance, CHF-denominated IRDs are cleared predominantly by LCH Ltd and Eurex Clearing (ECAG), which cover respectively around 85% and 15% of the market for IRS, 65% and 35% of the market for Basis Swaps and have a similar share for OIS. However, ECAG ensures a larger coverage in terms of range of tenors, starting from 2D (28D LCH Ltd). For other classes such as the DKK and JPY-denominated products, ECAG has no current activity, even if the CCP is authorised and able to ensure the largest coverage in terms of range of tenors. Depending on the dynamics of the clearing activity on the continent in the future, further reviewing the scope of the clearing obligation may therefore have a positive impact on volumes.

For Single name CDSs, the final report on clearing obligation published by the ESMA in 2015[1] excluded these asset classes from its scope, without disregarding the possibility for a future extension of the obligation. A potential approach could rely on the assessment of the liquidity of the constituent of key CDS indices first (before looking at less liquid single names), either financial (notably CDSs on reference entities being systemically important banks) or non-financial. This should thus cover financial and non-financial European corporates (EUR) and financial and non-financial North-American corporates (USD), for which a clearing offer already exists in ICEU and/or LCH SA up to a 10-year tenor.

It is important to mention that the Banque de France and the ACPR think that an extension of the clearing obligation must be supported by a technical assessment, which should take into account the specific characteristics of each asset class and assess the risks, potential costs and benefits. A specific mandate may be entrusted to ESMA in this regard.

2. <u>Measures towards risks participants</u>

a) Capital requirements in CRR and supervisory tool

General remarks – relate to:

Question 1. EMIR 2.2 introduced a difference between third-country CCPs which are Tier 1 and those that are Tier 2. How could the greater systemic importance (and associated risks) of Tier 2 third-country CCPs be reflected in the context of banking rules and supervision?

Question 2. What changes in the legal framework could translate in banks increasing their clearing activities in EU CCPs?

Question 3. How could a higher risk weight for excessive exposures to a Tier 2 CCP be designed given their systemic imprint?

Question 4. In light of the Commission strategy to reduce excessive reliance on Tier 2 third-country CCPs, what level could be appropriate in your view for the risk weight, to incentivise clearing members to consider other options than a Tier 2 CCP for clearing their derivatives?

Question 5. How do you assess the risk that participants would relocate clearing to other third-country jurisdictions in case a higher capital requirement on excessive exposures to T2 CCPs is imposed?

Question 6. Do you include in your operational risk framework scenarios including limitation of access/non-recognition of a third-country CCP, or activation of the EMIR 2.2 process under Article 25.2c (i.e. possibility of de-recognition of a third-country CCP or certain clearing services)?

Question 7. When would you consider that a clearing member's exposure (initial margin and default fund contributions) to a CCP be "excessive"?

ESMA assessment stressed the need for EU financial players to rebalance their clearing activities from UK CCPs to EU CCPs in order to reduce financial stability risks, and specified that such rebalancing should be incentivised by prudential tools. The Banque de France and the ACPR are of the opinion that micro-prudential tools, complemented with other exposure reducing measures, are necessary to trigger a significant rebalancing movement. Such measures would have to start to be implemented as soon as possible, together with measures aiming at increasing the EU clearing capacity. As a matter of fact, rebalancing of exposures would need to be a progressive process. It would contribute in bringing more liquidity in the EU, and thus would have to complement and incentivise efforts to improve the EU offer.

[1] https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-1481_final_report_clearing_obligation_index_cds.pdf

The competent prudential supervisory authorities, ECB/SSM as well a non-EEA/EU supervisors, could require EU banks under their supervision to develop their own strategies to reduce their exposures to UK CCPs. They could define their expectations in line with system-wide exposure reduction targets which could be set by EU co-legislators and/or the Commission in level 1 and level 2 texts.

Indeed, a first necessary building block would be the system-wide targets for exposure reduction. In our opinion, the principles and general criteria of the system-wide reduction targets should be set in level 1 text (i.e. EMIR regulation). The Commission would then be entitled to quantitatively define the system-wide targets in a level 2 text (e.g. delegated regulation or implementing act).

	Strongly agree	Rather agree	neutral	Rather disagree	Strongly disagree	No opinion
a higher risk weight for the portion of the exposure which is above a certain threshold	x					
a higher risk weight for the overall exposure to the CCP concerned		x				
a higher risk weight if there is evidence that no meaningful efforts are made to reduce the exposure	x					

The second building block of this framework would be the determination of reduction targets per institution under the Pillar 2 framework. A Pillar 2 treatment is justified since excessive exposures to UK CCPs notably entail financial and operational risks for EU banks which are not or insufficiently considered under Pillar 1. On this matter, EBA endorsed on 15 February 2022 revised Guidelines for common procedures and methodologies for the Supervisory Review and Evaluation Process (SREP), which include the necessary reduction of excessive exposures to systemic UK CCPs as part of the overall analysis by competent authorities of counterparty and settlement risks incurred by supervised institutions.

While setting targets at individual level in terms of open interest would ensure full alignment with the system-wide objective set by the Commission, there may be merit in staying as much as possible in line with banking prudential regulation by defining “exposures” as trade exposures (i.e. margins and positions) and default fund contributions. This would allow leveraging on the already-existing supervisory reporting framework. Given that the COREP lines merge data related to different CCPs, a specific addendum may be needed to be created to keep track of specific exposures to substantially systemic UK CCPs, at an individual level vis à vis each CCP.

Should an EU bank not comply with the expectations set by the competent authorities, the latter could, after giving due consideration to the specific circumstances presented by the bank, impose to the bank a supervisory measure (i.e. capital surcharge) under the Pillar 2 framework, as per SREP methodology. Taking into account individual risk profiles, banks with the most significant exposures could be required to reduce them by a larger amount than banks with moderate exposures. In order to do so, banks should be assigned specific capital surcharges on the exposures in excess of the set target by imposing higher risk-weights on these amounts. Such differentiation would be justified as the most exposed banks would be the ones to suffer the most in case of disruption of UK CCPs, in particular in the application of resolution tools.

Higher capital charges would allow to reduce financial stability risks identified by ESMA both by increasing the resilience of EU entities and by fostering the reduction of exposures to UK CCPs. Even if the resulting capital requirement at the level of the whole institution may not be huge, specific capital surcharges at the very level of CCP exposures (e.g. through adjusted risk-weights) could constitute an efficient incentive for rebalancing, as they would impact the profitability of the clearing business line.

The risk that part of the exposures migrate to T1 CCPs would be reduced if micro-prudential measures are complemented, and not replaced by (i) measures steering migration towards the EU, proposed by the Commission in the consultation paper (widening of the clearing obligation, active account with quantitative requirements…), (ii) the development of an EU offer on the considered asset classes. It should also be reminded that any significant migration of business to current T1 CCPs would make them cross the T2 threshold, thereby subjecting them to additional ESMA prerogatives.

Alongside this exposure reduction framework, competent authorities should also require clearing members with exposures to Tier 2 CCPs to include scenarios corresponding to the limitation or lack of access to these CCPs within their scenarios analysis for their operational risk management.

The above-mentioned proposal takes advantage of the upcoming EMIR review in order to act swiftly. While other options such as revising the Pillar 1 framework could be potentially relevant as well, they would not be in line with the timeline of the objective of rebalancing. This is for example the case of the suggestions to adjust the QCCP or Large Exposure treatments in CRR – given that the ongoing CRR revision will only enter into force in 2025.

b) Macroprudential tools

General remarks – relate to:

Question 1. The over-reliance on Tier 2 CCPs presents risks for the financial stability of the Union. Do you think macroprudential tools should be considered to achieve the desired policy objectives, alongside or as a substitute for the use of micro-prudential tools? Please explain your reply in as much detail as possible.

Question 2. Do you think a macroprudential buffer should be considered in light of this reliance/exposure?

Several measures could contribute in setting an efficient exposure reduction framework.

Setting system-wide exposure reduction targets would first imply a definition of “excessive exposures” and serve as a benchmark to calibrate exposure reduction measures. They would provide ground for

EBC/SSM to define targets at entity level in order to apply micro-prudential requirements and could inform the triggering of a macro-prudential buffer at system level.

Indeed, macro-prudential measures could be combined with a micro-prudential approach based on increased risk-weights or add-ons and potentially facilitate the inclusion of all EU countries as well as non-bank entities in the incentive framework for rebalancing exposures, and further incentivise the industry to respect the targets. Notably, the ESRB could recommend relevant authorities to apply a sectoral systemic risk buffer to the subset of exposures to substantially systemic third country CCPs, as per Article 133(5)(f) CRD, or to consider a new dedicated systemic risk buffer applied to the EU exposures to systemic third-county CCPs, as per art. 458(2) CRR.

c) Set exposure reduction targets

General remarks – relate to:

Question 1. If targets were to be set in some form or another, what do you think could be a reasonable target to achieve in terms of reduction of overall euro-denominated exposures of EU participants to Tier 2 UK CCPs? Should exposures to systemic non-EU CCPs somehow be capped?

Question 3. Please indicate whether the targets should be set:

- at a global level (all EU clearing members)- at clearing members' level

- at clearing member and client levels

Question 4. What could be the targets for the services identified by ESMA as being of a substantial systemic importance:

- Swapclear by LCH Ltd, for both euro and Polish Zloty-denominated products.

- The STIR futures by ICE Clear EU for euro-denominated products.

- The CDS Service by ICE Clear EU for euro-denominated products.

Please explain your answer providing, where possible, quantitative evidence and examples, including on potential costs and benefits.

Question 5. What factors should be taken into account in your view when sizing the target and setting the timeline for meeting it?

ESMA assessment under article 25(2c) concluded that the substantial systemic importance of the three services under review was notably due to excessive exposures of EU members and clients and overreliance of the EU financial system as a whole. While the assessment pointed the need to reduce this overreliance, it did not call for a total relocation of exposures, considering that at this point in time, costs of doing so would exceed benefits. These conclusions call for maintaining part of EU exposures to UK CCPs while reducing them enough to bring the importance of the three services down, from a "substantially systemic" to "systemic" level.

Defining ambitious though reasonable exposure reduction targets is necessary to achieve this objective. Market participants call for a quantitative definition of what would be a sufficient diminution such that it would address overreliance, in order to gauge the rebalancing effort they would have to undertake. In addition, public authorities need to determine a common target in order to agree on the means to achieve it. Furthermore, defining risk reduction targets would give credibility to the process, as EU authorities would take more binding regulatory measures, should these targets not be attained at the end of the second temporary equivalence period.

Setting exposure reduction targets would require EU authorities to define the border between "systemic" and "substantially systemic". In this respect, the thresholds from the Delegated Act on tiering, which provides a view on such a border, could give some sense of the level of exposure reduction that would be needed to bring overreliance on UK CCPs to an acceptable level. While further work is needed to define precisely the level of the thresholds, they would have to be set with the aim to bring exposures above but closer to the Tier 2 thresholds, which are currently crossed by a factor of more than 80 by IRDs and of 3 by STIR.

Financial stability risks raised by overreliance on UK CCPs is also a macroeconomic issue. Exposure reduction targets would thus have to be defined at global level. Nevertheless, in order to incentivize all EU financial actors to contribute to this global objective, they would have to be translated at the individual level, i.e. at least for each clearing member and possibly for major clients.

These targets could thus serve as a point of reference for other exposures reduction measures. First, they would inform the definition by EU authorities of the timeframe along which the minimal level to be held in the active account would increase – should this solution be adopted. Second, the definition of such targets by the Commission would provide additional ground to micro-prudential authorities to impose additional capital requirements on excessive exposures.

In order to strengthen the credibility of this set of measures, the Commission would benefit from communicating that it reserves itself the right not to grant a new extension of the UK equivalence decision on clearing, should the targets not be met at system level. Such condition for a third renewal of equivalence would form a backstop at system-wide level, complementing the risk-reducing measures at entity level.

d) Level playing field

General remarks – relate to:

Question 1. How in your view could this issue be avoided? Please explain your answer providing, where possible, quantitative evidence and examples including on potential costs and benefits.

Question 2. In what ways can the clearing of Union currency-denominated derivatives be made obligatory or incentivised to take place in EU CCPs? Please explain your answer providing, where possible, quantitative evidence and examples including on potential costs and benefits.

Question 3. With specific reference to question 2, how could end clients which are not subject to the CRR be incentivised? Please explain your answer providing, where possible, quantitative evidence and examples including on potential costs and benefits.

In response to Q1 and Q2, we believe there is a possibility to implement a requirement for non-EU clearing members to clear in EU CCPs.

This could take the form of a “swap dealer” license that would replicate the framework applied to EU clearing members aiming at rebalancing exposures towards EU CCPs.

The scope of application would be linked to the activities and/or currencies at stake. In this regard, several options could be considered for determining the scope of financial services subject to the “swap dealer” requirement:

- Scoping option 1 (small scope): providing client clearing services to EU clients. A priori, it would not appear necessary to further specify this scope by adding a currency criterion, since the “swap dealer” status would by design replicate the measures decided for EU entities, which will only deal with EU currencies (as per the substantially systemic determination of the three services of LCH Ltd and ICEU in EUR and PLN).
- Scoping option 2 (broader scope): include all clearing in EU currencies, rather than limiting the scope to client clearing services to EU clients. This option would have the advantage of requiring the rebalancing of a broader share of activities of non-EU entities towards EU CCPs, i.e. not only client

cleared trades, but also proprietary and market making positions in EU currencies, thereby increasing the liquidity pool. It would also level the playing field with regard to activities on behalf of non-EU clients. However, the extraterritorial constraint would be more pronounced.

- Scoping option 3 (extensive scope): include all of the above (i.e. all clearing in EU currencies) and add all clearing activities on EU underlyings (sovereign, corporate or indexes). This would allow to also tackle, for instance, the business of EU Sovereign CDS, which are denominated in USD but nevertheless have a potential impact on EU financial stability.

Regarding the actual treatment imposed to non-EU clearing members, as stated above this would need to mirror the treatment of EU clearing members to the closest extent possible:

- If the treatment of EU members is a Pillar 2 framework with capital surcharges on excessive exposures to UK CCPs, there may be different ways to adapt this to non-EU "swap dealers":
  - The closest way to mirror this treatment would be first to impose capital requirements to non-EU swap dealers, so that excessive exposures to UK CCPs could be then subject to specific surcharges. This would imply a new form of extraterritorial power for the designated EU prudential supervisor (e.g. ECB) or market authority (e.g. ESMA), since it would have to monitor the capital situation of offshore banks. The EU prudential supervisor may need to tailor the capital surcharges to the individual situation of each "swap dealer", which would require sufficiently detailed reporting from these entities.
  - A more basic solution could be to simply require the offshore "swap dealer" to locate some part of its clearing business in an EU CCP. This would be simpler, however more asymmetric, since EU members would "only" be subject to capital surcharges if they do not locate enough clearing business in an EU CCP while the latter would be legally forced to do so (implying sanctions or withdrawal of the swap dealer license in case of non-compliance). To mitigate this concern, the framework might set *de minimis* thresholds in terms of activity under which offshore swap dealers would not be required to redirect their clearing towards an EU CCP. The scope of products concerned may also be further restricted.
- If the treatment of EU members is a macro-prudential tool, the reasoning above still applies: perfect replication to non-EU swap dealers would necessitate the development of a prudential supervision framework, while the more basic alternative would be to mandate non-EU "swap dealers" to locate the relevant part of their clearing business in an EU CCP.
- If the treatment of EU members is an outright requirement to clear certain products in EU CCPs, then the replication to non-EU "swap dealers" would be considerably easier. This option could be followed if the Commission decides to review the derivatives clearing obligation to mandate clearing of certain products in an EU CCP (rather than in a recognised CCP), or if a future review of EMIR introduces changes with a similar effect.

In response to Q3, we believe the ESAs in charge of supervision of major clients (e.g. EIOPA for insurance companies and pension funds) should set expectations for them to reduce their exposures to UK CCPs. A priori, tools exist within the relevant sectoral supervisory frameworks to incentivise rebalancing in a manner similar to a potential Pillar 2 treatment under banking regulation.

e) Facilitate transfer of contracts from outside the EU

The Banque de France and the ACPR do not provide observations on this point.

f) Obligation to clear in EU

The Banque de France and ACPR are of the opinion that a revision of the Art. 5 of EMIR in order to set a requirement for EU participants to fulfil the clearing obligation only in an EU or a non-EU Tier 1 CCP, would be an effective tool to attain an exposure reduction, yet it must be carefully assessed and subject to certain conditions. Indeed, this measure would have a much broader scope than a decision of de-recognition of UK CCPs, by banning the clearing of some products in any non-EU Tier 2 CCP. It should however be made clear that this measure would only concern EUR-denominated asset classes subject to the clearing obligation, emulating therefore the decision of Japanese authorities for JPY-denominated IRSs and local CDSs.

This option would be particularly effective in reducing the exposures of EU participants to UK CCPs Tier 2 and foster the creation of a liquidity pool in the EU, yet, in order to prevent unintended consequences it must be carefully assessed.

One counter-argument to this approach is that the strong dependence of the EU clearing activity to EU CCPs may result in higher trading costs (compared to the ones assessed in case of the de-recognition) and a worsening of the level-playing field for EU entities, for example in case of an increase of the basis (i.e. the price differential that reflects the margin costs of clearing at one CCP versus another one) between LCH Ltd and EU CCPs for EUR-denominated products. However, it is worth noting that the Japanese CCP JSCC has successfully managed to mitigate these potential effects by attracting non-Japanese clients, which have not only contributed to improve market liquidity and supply-demand balance, but also potentially levelled the playing field between clearing members who can clear at LCH Ltd and those who cannot.

In addition, such decision may be deemed as a very conservative message and also lead other jurisdictions to embrace a similar policy which would result in a higher fragmentation of the clearing activities. This risk could however be mitigated by limiting the requirement to only the portion of exposures above specific thresholds, in order to directly link this measure to the general objective of reducing EU exposures.

g) Active account

General remarks – relate to:

Question 1. How would you define an active account? Please explain your answer providing, where possible, quantitative evidence or examples, including on potential costs and benefits.

Question 2. Should the level of activity be quantified?

Question 3. Should the set level of activity evolve overtime, and based on what criteria?

Question 4. How would an active account work for omnibus client accounts?

Question 5. How can client clearing service providers ensure that clients maintain an activity in EU CCPs?

Question 6. What would be the pros and cons, the costs and benefits of mandating the opening of an active account and setting a regulatory level of activity in it?

Question 7. Would it be useful to impose requirements (e.g. having an active account at an EU CCP) on international banks having a subsidiary in the EU for retail activities?

The Banque de France and the ACPR consider as relevant the solution to require EU participants to hold an active account in an EU CCP, provided it sets clear and quantitative levels, in order to achieve the ultimate objective of reducing the exposures to UK CCPs. Indeed, it could allow reducing two financial stability risks related to the overreliance on UK CCPs, identified in the ESMA assessment under Article 25(2c). It would first ensure EU institutions have a fall back solution in place, should their access to UK CCPs be suddenly restricted. Moreover, it would accompany the rebalancing of exposures, by both compelling EU participants to reduce part of their exposures to UK CCPs and transferring them to an EU CCP.

In order to achieve these two risk-mitigating effects, the minimal level of activity should be sufficiently demanding. While requiring EU participants to hold constant activity so as to ensure the operational functioning of the account would increase their resilience in case of sudden off-boarding from a UK CCP, it would fall short in triggering any significant rebalancing movement. As a matter of fact, most of EU participants to UK CCPs already hold an account in at least one EU CCP. Thus, the additional liquidity that such a requirement would bring in the EU would likely have no major impact on the EU liquidity pool. Conversely, requiring EU participants to hold a significant part of their exposures in EUR in their active account would bring important volumes to the EU and provide further incentives to other participants to progressively clear on the continent.

This advocates for defining “active account” quantitatively, by setting thresholds in the regulation to be reached for the EU participants to be compliant with the requirement. The thresholds would provide a clear signal to the EU participants and certainty to EU authorities regarding the level of rebalancing they could achieve. The thresholds could take the form of a minimal percentage of EU firms’ expositions in EUR expressed of notional outstanding or open interest. Such thresholds could be supplemented by qualitative guidance, concerning for instance the directionality of the positions held in the account.

A balance between the efficiency of the measure and the limitation of the costs, notably for EU participants, would have to be achieved. On this matter, a gradual evolution of the thresholds would allow EU clearing members to progressively rebalance their positions and to benefit from the improvements of EU clearing offers. The governance of these gradual quantitative requirements would have to provide both visibility to stakeholders regarding the final objective of the measure, and flexibility to EU authorities to adapt to any political or financial event. Thus, the timeline could foresee the following: (i) predefine the gradual increases of the thresholds, (ii) set the dates at which the relevant authorities would review the level of the thresholds, (iii) or determine a final quantitative level of exposures that EU members would have to hold in their account by June 2025 while letting EU authorities the margin of manoeuvre to decide the level of increase of the thresholds at each review. The last solution would have the advantage of providing certainty to stakeholders by defining ex ante what would be a successful and sufficient level of rebalancing, while preserving some margin of manoeuvre for EU authorities to adapt to any event. The final level of the thresholds would be defined in coherence with the targets, as developed in (2 c).

This gradual approach might also be adopted from a legal viewpoint. In order to be efficient, the active account solution would have to be enshrined in EMIR or another Level 1 regulation. Nevertheless, pending the entry into force of such regulation, the Commission could adopt a guidance in the short run to ask EU actors to open an active account in an EU CCP, and announce its intention to reflect such requirement in the upcoming EMIR review, foreseen in 2023. The expected final level of the threshold in June 2025 or the intermediate increases would benefit from being communicated to market participants before being transposed in the Level 1 regulation, in order to provide visibility to stakeholders.

Finally, the scope of the measure would have to be as wide as possible. In terms of product, the requirement could first target the products which the ESMA and the ESRB considered as substantially systemic, that is IRD in EUR and PLN, and CDS and STIR denominated in EUR and PLN. In terms of activities, there is a need to both ensure the efficiency of the measure and allow EU members to keep part of their activities particularly subject to international competition in UK CCPs (market or client clearing). Nevertheless, exempting these specific activities, which represent an important proportion of their total exposures, would reduce the efficiency of the measure. Instead of setting exemptions, it would be preferable to define ambitious though reasonable quantitative thresholds and apply them to a wide range of EU activities. Indeed, it would guarantee the efficiency of the measure and grant EU participants some leeway to preserve their key activities in the UK. In addition, a gradual application of the measure, in the conditions mentioned above, would progressively reduce the competitive disadvantage EU participants would suffer by rerouting part of their activities to EU CCPs.

Besides, in order to further steer clearing activities towards EU CCPs, there would be merit in complementing the “active account” measure with a requirement for all EU clearing members to provide an option for their clients to clear in an EU CCP, as proposed in the Commission’s consultation paper. This would allow ensuring that clearing activities in EU CCPs are not confined to residual, own account trades and induce a more significant migration of the client liquidity pool.

On their side, clients could also be required to have at least operational backup arrangements that would allow them to transfer their clearing activities to an EU CCP in a reasonable timeframe, should the access to substantially systemic UK CCPs be interrupted.

h) Hedge accounting

The Banque de France and the ACPR do not provide observations on this point.

i) Transactions resulting from Post Trade Risk Reduction (PTRR)

> *General remarks – relate to:*
>
> *Question 1. In your opinion, to what extent could the current outstanding notional amount be reduced? Please explain your answer providing, where possible, quantitative evidence or examples, including on potential costs and benefits.*
>
> *Question 2. How should the resulting risk replacement trades be treated with regard to the clearing obligation? Please explain your answer providing, where possible, quantitative evidence or examples, including on potential costs and benefits.*
>
> *Question 3. What would be the pros and cons, the costs and benefits of subjecting the risk replacement trades to the clearing obligation? In EU CCPs?*

PTRR services can be efficient in reducing notional amounts and exposures, and can be positive from a financial stability perspective. Therefore, in order to favour the use of those services, a revision of the current operational, regulatory and reporting framework in which these entities operate could be envisaged. In particular, a possible exemption of risk-reduced trades from the clearing obligation, even limited in time, might help untie some entities from their excessive dependence to third country CCPs. However, the potential risks that this exemption is used to circumvent the clearing obligation would have to be thoroughly assessed. Alternatively, one might envisage instead to subject risk-reduced trades to a clearing obligation in an EU CCP in order to actively steer migration of trades towards the EU.

j. Fair, reasonable, non-discriminatory and transparent (FRANDT) commercial terms for clearing services

> *General remarks – relate to:*
>
> *Question 1. Should the provision of client clearing services be further regulated so that clients are consistently offered the option to clear also at one EU CCP or incentivised to do so?*

A requirement for all EU clearing members to provide an option for their clients to clear in an EU CCP would be a good measure to further steer clearing activities towards EU CCPs. Such a measure, quite straightforward for clearing members to implement and at a minimal cost, would contribute to fostering a more significant migration of the client liquidity pool.

3. <u>MEASURES TOWARDS CCPS</u>

a) Measure to expand the offer by EU CCPs

General remarks – relate to:

Question 2. Would it be appropriate to envisage a faster approval for certain types of initiatives which could support the objectives of promoting clearing in the EU? What would be the pros and cons of a quicker approval process?

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

The article 15(1) of EMIR and related RTSs provide that a CCP wishing to extend its business to additional services or activities not covered by the initial authorisation shall submit a request for extension to the CCP's competent authority, and define the conditions under which the request of authorisation should be triggered. The current procedure ensures that a CCP is scrutinised by multiple authorities, hence its approach is subject to sufficient challenges via various perspectives. This process leads to more resilient overall outcomes and appropriately reflects the cross-border nature of clearing business within the EU.

The current process foresees that the NCA(s) should declare the completeness of the application within 30 days of its reception and then submit to the EMIR College a risk assessment within four months. The College has 30 calendar days upon the receipt of the NCA risk assessment to form a joint opinion. In addition, ESMA will adopt an opinion on the coherent application of EMIR provisions in parallel to adoption of the college process, which will have to be submitted within 20 working days. The Banque de France and the ACPR are of the opinion that the current processes provide authorities in the supervisory college with an appropriate timeframe to assess the changes from the perspective of their mandates, and leave little scope for further streamlining the already short timeline.

We think that better ways to speed up the approval process may be through providing further guidance to CCPs in their application process in order to facilitate the NCAs' assessment and get a faster declaration of completeness and approval. This may be achieved through better defined guidelines for CCPs, definition of template to support specific applications, clear definition of type of documentation needed and elements for the risk assessment.

The Banque de France and the ACPR do not support the idea of an ex-post approval. The approval of new clearing services and activities should be supported by an in-depth risk assessment by the relevant authorities to assess the impact that the extension may have on financial markets and on the CCP's activity, as well as to verify that the CCP has identified on its own all the potential impacts of the new activity, the measures to treat identified impacts, as well as ad-hoc adjustments needed in terms of risk management framework (such as the definition of an ad-hoc margin add-ons or stress scenarios). All these aspects must be verified and treated before the launch of a new product or service. Additionally, the operational costs for the CCPs may be higher in case of an ex-post denied approval.

b) Payment/settlement arrangements for central clearing

General remarks – relate to:

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

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

Industry feedback regarding the operating hours of TARGET2 raises the need to widen time periods available, which is indeed an option which is currently foreseen.

c) Require segregated default funds

General remarks – relate to:

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

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

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

From a risk perspective, the Banque of France and the ACPR are of the opinion that the segregation of default funds is an important element of risk management, allowing to preserve the activity of services not impacted by the default of a member (or multiple members),to protect clearing members from being exposed to risk of other asset classes and facilitate the default management. Generally CCPs segregate default funds by clearing service, considering aspects such as the caracteristics and type of the clearing offer, the magnitude of the service, the degree of correlation across the different asset classes, and degree of risk of a specific asset class. The segregation of defaut funds may be particularly relevant, for instance, in a CCP that has several systemic clearing segments. Also clearing members, especially those operating only on one or few business lines, generally consider CCPs with segregated default funds more secure. Only members, generally those with large exposures in multiple asset classes, may consider attractive to have a single default fund to benefit from diversification effects.

Hence, we support the idea that EMIR should be more prescriptive concerning the establishment of segregated default funds, which should be adopted as a prudential standard. However, we also think that any regulatory measure should also leave flexibility for authorities to assess particular cases where a single default fund across multiple asset classes may be beneficial, without lowering prudential standards (for instance when asset classes have similar characteristics or have correlated products).

d) Enhancing funding and liquidity management conditions

General remarks – relate to:

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

Regarding CCP investments, one option could be to extend the list of financial instruments that are considered highly liquid with minimal market and credit risk, in accordance with Article 47 of EMIR, for instance to securities issued by supranational entities. However, we would not favour at this stage an extension to MMF shares, as the 2020 market stress raised some concerns on their immediate liquidity.

Regarding the access of EU CCPs to central bank liquidity facilities, it should be reminded that this competence strictly belongs to central banks as per EU law. Central banks are aware of calls by some CCPs to extend the access to central bank liquidity facilities. On this matter, it should first be recalled that the monetary policy framework provides access to the central bank's standing credit facility to all entities that are authorised as credit institutions. In this regard, EMIR specifically mentions that national competent authorities are able to grant banking licenses to CCPs in their jurisdiction. Hence, solutions already exist and are in the hands of national competent authorities if extension of central bank liquidity facilities to additional CCPs is desired.

Should other avenues than the standing monetary policy facilities be explored to grant further access to EU CCPs to central bank liquidity, authorities should proceed with caution and put in place appropriate safeguards to ensure that EU CCPs only rely on such facilities in significant crisis situations.

e) Interoperability

General remarks – relate to:

Question 1. Do you think EMIR should explicitly cover interoperability arrangements for derivatives? Only for Exchange Traded Derivatives or also OTCs? Please explain your answer to question 1 providing, where possible, quantitative evidence and examples.

Question 2. In light of efforts to enhance the clearing capacity in the EU and the overall attractiveness of EU CCPs, do you think there would be benefits of developing interoperability links between EU CCPs? If yes, which ones? What do you think would be the costs?

Question 3. Do you think interoperability arrangements for derivatives between EU CCPs could contribute to enhancing the overall liquidity at EU CCPs? Why?

Question 4. How would you assess a situation in which Interest Rate Swap clearing happens at more than one EU CCP (e.g. at 2 CCPs) and there is an interoperability link between the two concerning such products? Would this be more convenient for market participants?

Question 7. Would allowing for cross-margining arrangements in the EU be useful/desirable?

While the Banque of France and the ACPR recognise that interoperability arrangements can help to increase liquidity of the market and reduce costs of fragmentation, they also think that European authorities should be very careful in promoting a broad use of these arrangements for the mere objective to expand the European clearing offer.

These arragements are generally used to clear transferable securities, such as cash equities and bonds, which are less complex in terms of operational and risk management, than derivatives. For these cash asset classes, the establishment of links, when subject to robust default and risk management frameworks, may have benefits in terms of netting efficiency and market liquidity. However, for derivatives products, especially OTC derivatives, these arrangements may be a significant source of increased risks for the financial stability, adding significant complexity into the risk management of linked CCPs and being direct channels of contagion between CCPs.

We are therefore of the opinion promoting interoperability arrangements to derivatives should be considered carefully and subject to strong oversight and regulatory measures.

4. Monitoring progress towards reduced reliance of EU participants on Tier 2 CCPs

The Banque de France and the ACPR do not provide observations on this point.

5. Supervision of CCPs

General remarks – relate to:

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

Question 2. In your view, what would be the benefits of a stronger role for EU-level supervision?

b) How should EU-level supervision be given a stronger role?

Question 2: Please indicate how to give a stronger role to EU-level supervision:

d. Stronger EU-level supervision and a strengthened supervision could be ensured though the closer/stronger involvement of ESMA, for example by introducing a stronger mechanism to ensure compliance with its opinions and recommendations and in a wider set of areas;

e. Stronger EU-level supervision and a strengthened supervision could be ensured through closer/stronger involvement of the central banks, in particular in areas relevant to the transmission of monetary policy or the smooth operation of payment systems (liquidity risk control, margin requirements, collateral, settlement arrangements or interoperability arrangements).

Question 3: To ensure stronger EU-level supervision, which of the following authorities or bodies should be more closely involved in supervision?

Question 4. If a distinction between EU CCPs were to be made under the EU supervisory framework as per point (b) of Q3, please indicate if you agree that the following criteria are relevant (volume and value of central clearing activity, interconnectedness with other CCPs, scope of products centrally cleared, geographical scope of trading venues connected, geographical scope of clearing members and clients, other).

d) ESMA's role in fostering a coherent application of EMIR

Question 1. In your view, how could ESMA's role in fostering convergence and coherence of the application of EMIR in the EU (e.g. among national competent authorities and CCP supervisory colleges) be improved.

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

The current European setup for the supervision of CCPs has proved efficient, with national competent authorities (NCAs) benefiting from their proximity with and diverse knowledge of national CCPs, in line with their specific prerogatives (e.g. market authorities, prudential authorities, central banks), to adequately supervise their activity, and ESMA ensuring the consistency of the implementation of the EU regulation. Nevertheless, there remains some room in progressing towards convergence between supervisory practices and in the fully consistent implementation of the EU regulation by NCAs. Moreover, the expected rebalancing of EU exposures from the UK to the continent would increase the systemicity of the most important EU CCPs and the cross-border impact of their decisions and policies.

While it is necessary to enhance the influence of authorities other than the NCAs (i.e. ESMA, CBIs, College members) on the supervision of systemic EU CCPs, transferring more responsibilities at the EU level might be at some costs. In particular, NCAs benefit from a strong knowledge of national actors and contexts, which are a guarantee of efficient supervision and good cooperation with CCPs. Moreover, the current supervisory organisation, which raised broad consensus during the EMIR 2 negotiations, is still new and could still improve over time.

This calls for deepening the current collegial system, rather than working on a new transformation of the supervisory framework only a few years after the entry into force of EMIR 2. Such improvement only requires to tackle a limited range of issues revealed in practice, such as the lack of convergence in the triggering of collegial procedures. It could also be achieved by widening or easing the use of the mechanisms that proved efficient in promoting good supervisory standards and practices, such as the article 49 procedure. Such enhancement of the collegial supervisory system would achieve several benefits, such as better favouring convergence, ensuring the level playing field between EU CCPs, spreading the good supervisory practices and thus increasing EU CCPs' resilience, and tackling the cross-border risks arising from greater amounts of clearing in the EU.

b) How should EU-level supervision be given a stronger role?

A proportionate approach, in line with the subsidiarity principle, would be both more politically acceptable and efficient. Drawing from the existing supervisory framework, it could mirror the tiered setup for third-county CCPs, that distinguishes between Tier1 CCPs, for which deference to the home authorities applies, and Tier2 CCPs deemed systemic for the EU and subject to ESMA's extraterritorial supervisory powers. As such, specific powers could be granted to authorities other than NCAs on EU CCPs designated as systemically important for the EU, while CCPs with a more domestic footprint would remain subject to the current supervisory framework

The ability of College members to influence NCAs remains limited (notably the tools provided by Article 17 EMIR have rarely, if ever, been used) and could be further enhanced. To this end, several options can be explored.

- *Triggering of a collegial procedure*

  NCAs keep an important margin of manoeuvre to decide to trigger collegial procedures or not. Although the upcoming Delegated Act on Articles 15 and 49 EMIR will reduce NCAs' discretionary power to refuse to qualify projects as "extension of activities" or "significant change" on the validation of which the College has to issue an opinion, their interpretation of the criteria provided by the act may differ and prevail on the College's.

  It could thus be envisaged to allow the College to have more influence in the triggering of collegial procedures, notably when a strong majority disagrees with the NCAs' view. For instance, Article 49 EMIR could be modified in order to provide that the qualification of a model change as "significant" can also be subject to a College vote whose result would be binding.

- *Strengthening College opinions*

  During collegial procedures, the influence of College members other than NCAs is limited. Opinions adopted under the ordinary procedure (Article 19) only have to be respected by NCAs on a "comply or explain" basis, and the triggering of the specific powers of the College under Article 17 is conditioned, in such a way that it has been seldom used, if ever.

  Increasing the influence of Colleges could make sense, notably concerning projects with potential cross-border impacts, given the expected increase of the European footprint of certain CCPs. This could concern important ownership changes (Article 32), outsourcing projects (Article 35) or significant model changes (Article 49). For instance, the College could be granted the power to impose a negative opinion if approved unanimously or after a qualified majority voting on such projects. This would allow the College to oppose to and stop the implementation of key projects validated by the NCAs but carrying important risks for other Member States until a setup agreeable for all or the large majority of jurisdictions impacted is reached.

  Another solution could be to ease the capacity of the College to request ESMA's binding mediation in case of disagreement with NCAs' decisions. For instance, the conditions related to this procedure could be reviewed to facilitate its triggering. In addition, it could be envisaged to extend the scope of this procedure to all cases where the College has to adopt an opinion (i.e. the scope of Article 19). Indeed, at the moment, binding mediation is only possible to solve disagreements on exemptions of clearing obligation for intragroup transactions (Articles 4 and 11), for the access of a venue to a CCP (Article 7) and for procedures under Article 17.

  The simplest and most ambitious way to implement these changes would be to create a single authorisation procedure – for instance by merging Articles 17 and 19 – for all important projects falling in the scope of the current Article 19 (i.e. projects from Articles 14, 15, 32, 35, 41, 49, and

54). This change would grant the College the two powers mentioned above (possibility of majority or unanimous rejection and binding mediation) for any authorisation, thereby extending the scope of the "stronger" authorisation procedure from Article 17 (which only applies today to projects related to Articles 14, 15 and 54, as mentioned above).

- *Strengthening the involvement of central banks of issue*

  The role of CBIs and their strong interest in the adequate supervision of CCPs could be better reflected, in particular with regard to the potential impact on the currency they issue and the liquidity tensions in this currency a CCP in distress could face. Indeed, the influence of their recommendations, for instance, whether adopted during a College opinion procedure (Article 19(1)) or at the occasion of ESMA's consultations (Article 24b), remains currently limited. In the same vein, it would be valuable to assess the need for a potential enhancement of the role of the SSM in the supervision of EU CCPs.

d) ESMA's role in fostering a coherent application of EMIR

Enhancing the EU supervisory framework could also benefit from an adjustment of ESMA's role, whether outside or inside Colleges, depending on their future role and influence. Conversely, the participation of all relevant authorities within ESMA's decision making bodies could be increased.

- *Adjusting the role of ESMA, whether inside or outside Supervisory Colleges*

  ESMA plays an important role to complement NCAs' supervisory action and ensure the convergence of good supervisory practices. Within Colleges, as a non-voting member, ESMA requests NCAs to provide information on projects, encourages NCAs to trigger collegial procedures, and influences the College's positions and votes. Outside Colleges, ESMA shares NCAs' validation power of significant model changes (Article 49).

  The influence of ESMA within Supervisory Colleges could be enhanced along with the increase of their role. In particular, ESMA could become a voting member, should Colleges be granted the power to trigger collegial procedures and to veto NCAs' major decisions after a qualified majority voting, as envisaged above. This would allow ESMA to fully benefit from these new collegial procedures, by more actively contributing to the elaboration of opinions of the College and by triggering voting procedures when necessary.

  Alternatively, ESMA's validation power could be extended to other important projects beyond the current scope, which covers only significant model changes (Article 49), such as extension of activities (Article 15), important changes in CCPs' ownership (Article 32) and outsourcing of important risk management activities (Article 35).

- *Enhancing the representativeness of NCAs in the ESMA decision-making process*

  Conversely, the representation of all relevant authorities within ESMA's decision making could be improved. Currently, EU supervisors are unevenly represented within ESMA's committees, which reduces ESMA's ability to articulate all relevant views. EMIR acknowledges the competence of CBIs and allows Member States to designate central banks, prudential authorities or supervisory (financial market) authorities as NCAs. While all these authorities are members of the CCP Supervisory Committee, only market authorities are voting members of the Board of Supervisors (BoS). Better representing all NCAs and CBIs in ESMA decision-making would be more in line with the supervisory organisation provided by EMIR, which acknowledges the diversity of views and competences, and necessary given the increasing systemicity of EU CCPs.

  In this respect, the creation of an Executive session of the BoS, dedicated to CCPs, as proposed in 2017 by the Commission remains relevant. The CCP Executive session would take decisions prepared by the CCP SC on behalf of the BoS, and would be composed of all NCAs as voting members and CBIs as non-voting members. This outcome seems feasible, since Member States did not oppose to the creation of an Executive session of the BoS but rather to the powers it would have had to validate or to oppose to a vast range of NCAs' decisions.