



**EACH response to the European
Commission consultation on post-trade in
a Capital Market Union: dismantling
barriers and strategy for the future**

November 2017

EACH Response – European Commission consultation on post-trade in a Capital Market Union: dismantling barriers and strategy for the future – November 2017

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1. Introduction

The European Association of CCP Clearing Houses (EACH) represents the interests of Central Counterparty Clearing Houses (CCPs) in Europe since 1992. EACH currently has 19 members from 15 different European countries and is registered in the European Union Transparency Register with number 36897011311-96.

EACH welcomes the opportunity to provide feedback to the European Commission consultation on '*Post-trade in a Capital Market Union: dismantling barriers and strategy for the future*'.

2. Response to specific questions

Q1: a) Which of the trends are relevant for shaping EU post-trade services today? Please indicate in order of importance (No concrete order suggested by EACH)

- (i) increased automation at all levels of the custody chain;**
- (ii) new technological developments such as DLT;**
- (iii) more cross-border issuance of securities;**
- (iv) more trading in equities taking place on regulated trading;**
- (v) improved shareholder relations;**
- (vi) a shift of issuances to CSDs participating in T2S.**

EACH Members believe that the following trends are the ones shaping EU post-trade services today:

- Regulation
- Technology (e.g. Distribution Ledger Technologies, Artificial Intelligence, digitalisation)
- Algorithmic trading
- Search for more efficiency and economy of scale
- Value shift and search for yield among asset classes

b) Are there other trends that are not listed above? Please describe and indicate in order of importance.

c) For each trend, please indicate if the impact on post-trade markets is:

- (i) positive - explain why and indicate if EU policies should further encourage the trend**
- (ii) mixed - explain why and indicate if EU policies should further encourage the trend or address negative implications**
- (iii) negative - explain why and indicate if EU policies should specifically address negative implications.**

Implementation of the G20 mandate on OTC derivatives

CCPs are financial market infrastructures that reduce and manage the counterparty risks in financial markets by becoming the buyer to every seller and the seller to every buyer of an original trade. They prevent the build-up of a network of exposures between market participants and aim to ensure that if one counterparty to the trade fails the others are protected by a prescribed default management procedure, allowing the market to continue to operate. Therefore, CCPs are by design crisis management infrastructures which cover current and potential future exposure between counterparties during the life of a trade. They perform this function through robust risk management tools, such as multilateral nettings, ex-ante collateralisation of market positions and a pre-agreed set of legal and operational rules in case of counterparty default.

OTC derivatives played a role in the financial crisis that erupted in 2008. As the European Commission stated, 'OTC derivatives in general and credit derivatives in particular carry systemic implications for the financial market. (...) their crucial role in virtually all the segments of the OTC derivative market (in the case of Lehman and Bear Stearns) had a negative spillover effect for the entire OTC market'. The European Commission stressed the opacity of the market and the lack of adequate risk management¹.

As a result of the crisis, on 25th September 2009, the G20 Leaders agreed on a set of measures to improve the functioning of the OTC derivatives markets by increasing its transparency and risk management and protection against market abuse. The measures agreed were:

- **Trading** of all standardised OTC derivative contracts on exchanges or electronic trading platforms.
- **Clearing** of all standardised OTC derivative contracts through CCPs.
- **Reporting** of all standardised OTC derivative contracts to trade repositories.
- Adoption of higher **capital requirements** for non-centrally cleared contracts.

The implementation of the measures above are shaping the EU and global post-trade industry by making it safer, more efficient and more transparent.

The increasing volumes of clearing are resulting in a larger part of the EU post-trading industry being subject to independent risk management. BIS paper 'Central clearing: trends and current issues' estimated the the clearing of interest rate swaps after the clearing almost doubled from 2012 to 2014 and for credit default swaps it increased by a factor of 4². BIS Statistical release of May 2017 estimates the percentage of Interest Rate Swaps contracts cleared through a CCP at 76%, of Credit Defatutl Swaps at 44% and of OTC foreign exchange (FX) at 1%³. This ensures that the adequate amount of collateral is exchanged and that enough

¹ 'Ensuring efficient, safe and sound derivatives markets', European Commission staff working paper, COM(2009) 332 final

² Graph 3, page 67 of https://www.bis.org/publ/qtrpdf/r_qt1512g.htm

³ See section 'Central clearing makes further inroads' on page 2 under https://www.bis.org/publ/otc_hy1705.pdf

resources are secured in case of default of clearing member or in case of a non-default event. The price of clearing services is determined through a multilateral and anonymous platform, that provides a fair price to all its participants. The increase in clearing volumes increases the levels of transparency in the EU post-trade industry: contrary to the pre-financial crisis time, understanding 'who owes what to whom' is now straightforward. This increases market confidence and benefits the EU economy as a whole. The transparency of the industry is also being fostered by the use of trade repositories, which centrally collect and maintain the records of derivatives.

Trading volumes through electronic trading platforms are also expected to increase in the EU further to the implementation of the related regulations. In the US, this increase has already been noted in the number of active Swaps Executive Facilities⁴.

d) Please specify the four main trends that will be the most important for EU post-trade
(i) in the next five (5) years
(ii) in the next ten (10) years

Implementation of the G20 mandate on OTC derivatives

The implementation of the G20 mandate is not yet fully completed in the EU. The full implementation of the measures included in the G20 mandate will therefore represent a trend in the EU-post-trading industry at least over the next five years. This will lead to an even safer, more efficient and more transparent market.

Supervisory convergence

We expect supervisory convergence across EU Member States to continue being a trend over the next five years. As indicated by ESMA, supervisory convergence ensures '*a level playing field of high quality regulation and supervision without regulatory arbitrage or a race to the bottom between Member States*'⁵. EACH Members fully support the continuation of the ESMA supervisory convergence work as a trend in the EU post-trading industry. Our views on supervisory convergence are included in our answer to question 5 below.

Access to clearing services

EACH Members believe that while it is important to ensure that sound regulation govern the post-trading industry, the balance between regulation and market efficiency should be achieved in order to avoid potential unintended consequences. In the clearing space, these potential unintended consequences include the narrowing of profit margins for clearing participants, their subsequent departure from the market and therefore an increased difficulty for end clients to access clearing services.

⁴ See chart 'SEF Market Share' under <https://www.clarusft.com/sep-2017-swaps-review-in-16-charts/>

⁵ <https://www.esma.europa.eu/convergence/supervisory-convergence>

Q2: a) Do you agree that the possible benefits of DLT for post-trade include the following elements? Please indicate in order of importance and add your comments if needed. (No concrete order suggested by EACH)

- (i) real-time execution of post-trade functions;**
- (ii) certainty on 'who owns what' where no intermediaries are involved;**
- (iii) redefining of the role of financial markets infrastructures;**
- (iv) changes to financial markets structure and competition between intermediaries and financial markets infrastructures;**
- (v) lowered costs;**
- (vi) others (explain).**

CCPs and technological developments

CCPs have always promoted the integrity, efficiency and transparency of global financial markets and the technological and other infrastructure advancements that have characterised the evolution of markets in recent years. These changes have been the catalyst for the development of more competitive, more efficient, and more transparent markets, as well as substantial improvements and innovation in risk management and regulatory capabilities. More recently, technological advances, regulatory pressures, and capital constraints are pushing the financial services industry to rethink many of its processes and structures, in order to facilitate cost reduction, and to make clearing and settlement more efficient. As these technologies advance, and are more widely adopted, they offer a more efficient means for market participants and market infrastructures to more efficiently manage their risk. It is perhaps too early to tell how far-reaching an impact these technologies will have on how participants trade, clear and report, but development is progressing at pace.

DLT in the clearing space

EACH generally recognises the possible benefits that DLT may bring to CCPs and to their participants (e.g. reduction of reconciliation processes and costs). We also believe that a comprehensive approach which carefully weighs the challenges and benefits of using DLT should be adopted when assessing how this technology could change the way CCPs operate. For instance, DLT may lead to a reduction of counterparty risk. However, this will only be true if DLT is implemented in a way that successfully reduces the settlement cycle, whilst preserving existing benefits relied on by market participants, including multilateral netting of positions. Netting reduces both counterparty and operational risk, especially in spot markets where volumes of transactions are high. CCPs perform unique functions of ensuring safe performance of clearing and risk management that may only be currently provided by EMIR-authorized entities. In order to contain the risk of creating 'unregulated areas' where entities could operate under lower standards, these requirements must be applied by any other entities performing them.

We believe that it would be unlikely to achieve a full automation for all post-trade services, in particular of the clearing process, given the regulatory and business complexity of automating

some services and essential functions. Hybrid models are likely to be first developed for products and services where automation will create greater efficiencies. Application to large scale and heavily regulated activities will take more time. There are some crucial aspects to the clearing process that will remain outside of automated processes, including default and crisis management as well as key functions of risk management. As the name implies a Central Counterparty is the counterparty to every position and its role is particularly important during default management. It is difficult to see how a decentralising technology like DLT would supersede this basic structural function.

DLT benefits

A variety of new technologies present possibilities for **cost reduction** and **reduction in the need for manual processes**, and these benefits are not solely limited to a DLT environment. Cost efficiencies in DLT depend on whether the proposed advantages can be effectively achieved, which is already a challenge for the current generation of financial technology innovation, including robotics, cloud computing and so on. As mentioned earlier, we believe that the reduction of intermediaries appears to be mainly theoretical in the present market conditions. Potential cost efficiencies could moreover only be achieved in the long-term perspective. DLT technology will likely have to be run in parallel to legacy systems to meet business and data security needs (as all players should agree on new standards and invest in new technology). Long-term, it may prove necessary to permanently maintain some data in parallel systems. At this point, it is unclear to say that DLT is guaranteed to reduce costs for participants.

b) Do you agree that the list below covers the possible risks that DLT may bring about for post-trade markets? Please indicate in order of importance and add your comments if needed.

(i) higher operational risks;

(iv) others – please specify (Security and timing; See comments in the response below)

(ii) higher legal risks related to unregulated ways in which services would be provided;

(iii) changes to financial markets structure and competition between intermediaries and financial markets infrastructures;

EACH believes that in analysing DLT in post trading the following risks should be taken into account:

- **Security** - While it is a widely held assumption that DLT is sufficiently secure to be used in financial markets, we would encourage that this assumption be tested and verified prior to the productive use of DLT. During the course of the implementation of DLT, it is key to have an agreed industry and international standard for data protection and confidentiality options for market participants. It is crucial that the high level of transparency provided by DLT does not conflict with the confidentiality obligations required for financial market participants.

- **Timing** – It is likely going to take a significant amount of time for industry-wide DLT adoption, if the market indeed decides to pursue this. Potential barriers to adoption may include the cost of conversion, interoperability between multiple DLT standards by multiple infrastructure providers, data and systems; fragmented regulatory policies, political timetables to fulfil regulatory changes required and competing non DLT technology.
- **Operational risk** - Failures in a DLT solution could potentially have far more wide-ranging consequences than currently faced by the industry, considering that DLT solutions are shared between a greater number of participants. Additionally, the interconnected and continuous nature of the system could create operational risks during deployment of system updates.
- **Legal certainty** - From a legal perspective, it is still unclear how DLT '*proof of work*' or '*mutually confirmed encrypted chains of trades*' will be evidenced and accepted as proof in courts, as well as across jurisdictions.

d) Do you have specific proposals as to how the existing post-trade legislation could be more technology neutral?

EACH believes that having **minimum industry standards** independent of the technology applied would represent a way to contribute to a more technology neutral post-trade legislation.

As with all technological advances, EACH would support the move towards DLT to be driven by industry and business needs, rather than regulatory edict, to ensure the technology meets the needs of market participants. If the industry moves in this direction, common principles and minimum industry standards should be established when it comes to setting up and operating distributed ledgers.

- Q3: a) Please list and describe the post-trade areas that are most prone to systemic risk.**
b) Describe the significance and drivers of the systemic risk concern in each of the areas identified.
c) Describe solutions to address the systemic risk concerns identified or the obstacles to addressing them.

Risks of legislative or non-legislative initiative reducing the resilience of CCPs

CCPs are financial market infrastructures that reduce and manage the counterparty risks in financial markets by becoming the buyer to every seller and the seller to every buyer of an original trade. They perform this function through robust risk management tools, such as multilateral nettings, ex-ante collateralisation of market positions and a pre-agreed set of legal and operational rules in case of counterparty default.

During the recent financial crisis, CCPs demonstrated their ability to successfully manage a default and prevent contagion across market participants and systemic risk. As a result of the crisis, regulators around the world agreed to support clearing through CCPs as a way to improve risk management in the OTC derivatives market. In the European Union, the implementation of the EMIR legislation established governance, conduct of business and prudential standards to ensure that CCPs can properly serve their goal as systemic risk controllers.

In order to ensure that CCPs continuously meet the standards of the EMIR legislation, they are supervised by authorities and subject to an **annual stress test exercise** performed by the European Securities and Markets Authority (ESMA), which aims to assess the resilience and safety of the European CCP industry and provide authorities with detailed information about the performance of stress testing undertaken by CCPs⁶.

The resources held by European CCPs to cover default losses (default waterfall) have proved in practice and in stress-tests to be adequate to cover the vast majority of circumstances, including the simultaneous default of multiple large clearing members (which imply the failure of their own resolution mechanisms). When combined with assessment powers, we consider that sufficient resources are available to enable **CCPs to withstand market stress and losses that would far surpass any scenario that could be deemed 'extreme but plausible'**. This assumption was confirmed by the ESMA EU-wide CCP Stress test 2015 report, which found that even *'reverse stress test scenarios constructed by further increasing the number of member defaults have not revealed plausible scenarios with systemic impact.'*

While we welcome the vast majority of the European Commission legislative proposal on CCP Recovery and Resolution⁷, we are concerned that the proposal to provide a compulsory compensation to clearing members as indicated in article 27(5) of the European Commission legislative proposal and in the draft report of the European Parliament⁸ would fundamentally change the stabilising risk management features of the CCPs, undermining the incentives of the clearing members to properly participate in the auctions and the broader recovery process. Reimbursing clearing member payments to the clearing community at the expense of the CCP (for e.g. variation payments to other clearing members) would therefore severely disrupt the risk management incentivise of CCPs and therefore **increase systemic risk** as follows:

⁶ <https://www.esma.europa.eu/press-news/esma-news/esma-publishes-results-eu-central-counterparties-stress-test>

⁷ http://eur-lex.europa.eu/resource.html?uri=cellar:b17255a7-b550-11e6-9e3c-01aa75ed71a1.0001.02/DOC_1&format=PDF

⁸ Draft report European Parliament on CCP Recovery & Resolution: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+COMPARL+PE-610.797+01+DOC+PDF+V0//EN&language=EN>

- **Breaks the link between the risk taker and the risk bearer** - Those that bring risk to the clearing community (clearing members) and are the primary beneficiaries of market continuity will pass the burden of their risk on to those that manage it (i.e. the CCP operator).
- **Financial stability is weakened** – The proposed amendments minimise the consequences for those that bring risk to the clearing community if the EMIR safeguards are overshoot. This weakens their incentive to participate in the EMIR default management process, therefore weakening financial stability.
- **Likelihood of a public sector intervention increases** – Shifting the burden from risk takers to risk managers in recovery disincentivises risk managers to perform recovery (i.e. they would rather tear-up the open positions than perform any other tool), therefore accelerating the intervention of the resolution authority.

In order to ensure that the EMIR legislative framework is not weakened, and systemic risk not increased, we would urge authorities to reconsider the proposal under article 27(5) of the EU legislative proposal on CCP Recovery and Resolution to compulsory compensate clearing members as well as any other proposal that would unduly shift the burden away from those that take risk in the markets to those that manage it.

Exemption of cleared derivatives from bail-in powers

In the context of the application of the bank recovery and resolution provisions relative to the potential for cleared derivatives to be subject to bail-in, it should be noted that having CCPs exposed to the risk that different resolution authorities take differing views as to whether cleared derivatives could be bailed in or not, would impact the enforceability of collateral and close-out netting arrangements by a CCP in a clearing member's default scenario. We believe that **resolution authorities should take a consistent approach on this matter and exempt cleared derivatives from bail-in powers.**

Bailing-in liabilities owed to CCPs could present significant challenges to the proper operations of CCPs and undermine financial stability. As you will appreciate clearing of trades through CCPs helps to reduce systemic risk and risk contagion. This is largely as a result of the comprehensive risk management arrangements employed by CCPs. An important aspect of risk management is that in normal circumstances a CCP runs a 'matched book' (i.e. any loss-making positions to which the CCP is counterparty are always matched by profit-making positions). In the event of a default, CCPs have rigorous procedures for the closing-out of clearing members' positions to re-establish a matched book. These arrangements crystallise losses at the earliest possible stage and prevent contagion to other market participants. The inclusion of centrally cleared transactions in the bail-in provisions could **increase systemic risk by potentially preventing CCPs exercising such powers.**

Access to central bank liquidity and central bank deposits

EACH believes there are two important measures that could address the potential systemic risk concerns that result from the CCP clearing industry being dependent on commercial bank providers and the markets to satisfy their liquidity needs: **a) Access to central bank liquidity** and **b) Access to central bank deposits**. These two measures are described below.

a) Access to central bank liquidity

EACH members support the possibility for CCPs to access central bank liquidity in order to promote the safety and efficiency of the markets. EMIR requires that CCPs have access to necessary credit lines or similar arrangements in order to perform its services and activities. CCPs can obtain these either from central banks or commercial banks. CCP access to central bank liquidity is currently not implemented consistently across the EU. Access to central bank money usually requires a banking license. Providing all CCPs across the EU with harmonised access to central bank liquidity creates not only a level playing field but also ensures an alternative source of liquidity for the CCP.

We believe that a banking licence should not be necessary to grant access to central bank liquidity. The access should include access to intraday and overnight facilities. The precondition for granting access should be the EMIR authorisation of EU CCPs.

EACH believes that **a change to the EMIR provisions is not necessary if all central banks within the EU agree** to providing access to such liquidity to the CCPs in their jurisdiction, as a complement to the objectives of EMIR. We understand that the final decision to grant access to central bank liquidity lies with the central bank.

EACH would like access to central bank liquidity to be seen as an additional tool, not mandatory under EMIR, a pre-requisite for authorisation or recognition or seen as a proxy for a liquidity deficit should a CCP not have access.

Importantly EACH believes that **the principle of access to central bank liquidity should also be promoted as a global standard for CCPs** irrespective of where they are located.

b) Access to central bank deposits

EACH Members consider that **CCPs should have access to accounts at central banks in order to deposit cash they receive as margin requirements and default fund contributions.** This approach would assist CCPs in limiting their exposure to commercial banks and comply with the EMIR rule under which no more than 5% of cash collateral, calculated over an average period of one calendar month, can be deposited on an unsecured basis. Notwithstanding this, EACH believes that the **requirement under Article 45.2 of the EMIR RTS 153/2013 for CCPs to reinvest no less than 95% of cash collateral in highly liquid financial instruments needs to be reassessed** in light of decreasing liquidity in short term financing instruments. EACH would support the creation of a technical working group between

the public authorities and the industry to perform the technical reassessment of these provisions. Therefore, it may be appropriate to allow CCPs to have further tools in order to reduce reliance on having to keep cash available to meet cash demands.

Q4: a) What are the main trends shaping post-trade services internationally? Please list in order of importance and provide comments if needed. (No concrete order suggested by EACH)

- (i) internationally agreed principles for financial markets infrastructures to the extent that they harmonise the conduct and provision of post-trade services;**
- (ii) lack of full harmonisation of internationally agreed principles for financial markets infrastructures;**
- (iii) the growing importance of collateral in international financial markets;**
- (iv) others – please specify.**

b) Which fields of EU post-trade legislation would benefit from more international coherence? Please explain why. (No concrete order suggested by EACH)

- (i) clearing;**
- (ii) settlement;**
- (iii) reporting;**
- (iv) risk mitigation tools and techniques;**
- (v) others – please specify.**

c) What would make EU financial market infrastructures more attractive internationally? In each case, please provide concrete example(s). (No concrete order suggested by EACH)

- (i) removal of legal barriers;**
- (ii) removal of market barriers;**
- (iii) removal of operational barriers;**
- (iv) others – please specify.**

d) Would EU post-trade services benefit from:

- (i) more competition – please explain in which area (clearing, settlement, trade reporting), and how this could be achieved**
- (ii) more consolidation – please explain in which area (clearing, settlement, trade reporting), and how this could be achieved.**

The role of international standards

International standards play a very important role in the field of clearing. Internationally harmonised risk standards should therefore be a priority for regulators. The global financial markets and linkages was reflected in the G20 commitment of 2009, through which major jurisdictions around the world agreed to the development of similar regulation for finance and the CCP clearing industry.

Since the signature of the G20 commitment, several international standards have shaped a harmonised set of legislation in different jurisdictions. These include the CPMI-IOSCO Principles for financial markets infrastructures⁹, the CPMI-IOSCO Public Quantitative Standards

⁹ <https://www.bis.org/cpmi/publ/d101a.pdf>

for central counterparties¹⁰, the CPMI-IOSCO guidance on Resilience of CCPs¹¹ and the FSB final Guidance on Central Counterparty Resolution and Resolution Planning¹².

In the EU, 32 CCPs have applied to be recognised in order to provide services to EU customers in line with international standards on capital requirements¹³.

Addressing the EPTF barriers

We believe that because of their focus on cross-border activities, addressing the different barriers identified by EPTF would be a good start to make EU financial market infrastructure more attractive internationally.

Q5: (a) What should the EU post-trade markets look like:

(i) 5 years from now;

(ii) 10 years from now.

(b) Please list main challenges to deliver on the vision you described above and rank, in the order of priority, which of those challenges should be addressed first: (No concrete order suggested by EACH)

(i) fragmentation of EU markets – please define in which market segments;

(ii) need for greater EU harmonisation of legal and operational frameworks – please define where;

(iii) need for more competition within the EU – as defined in your answers above;

(iv) need for greater consolidation – as defined in your answers above;

(v) lack of international competitiveness;

(vi) need for more regulatory coherence internationally;

(vii) financial stability issues;

(viii) others – please specify.

c) Please explain your views on each of the issues you listed above.

Within 5 to 10 years-time, the EU post-trade markets should aim to meet the following principles:

- **Safety** – Post-trade markets ensure that the economy can rely on a safe environment where to transfer risk. The safety of these markets will therefore always be paramount in the future.
- **Efficiency** – While ensuring the right levels of safety, post-trade markets should also continue to provide efficiency gains to market participants. In the clearing industry for example we see this through the reduction of collateral requirements corresponding to the reduction of net risks by netting and safe and sound portfolio margining.

¹⁰ <https://www.bis.org/cpmi/publ/d125.pdf>

¹¹ <https://www.bis.org/cpmi/publ/d163.pdf>

¹² <http://www.fsb.org/wp-content/uploads/P050717-1.pdf>

¹³ https://www.esma.europa.eu/sites/default/files/library/third-country_ccps_recognised_under_emir.pdf

- **Innovation** – To deliver on the above principles of safety and efficiency, post-trade markets should continuously strive to safely improve the product range and risk modelling in order to better serve their customers.
- **International competitiveness** – While meeting all the principles above, EU post-trade markets should remain competitive at an international level. As indicated in our response to question 4, this is particularly important in the clearing industry, since regulatory arbitrage should not drive business into systemically less robust jurisdictions.

To ensure that the EU post-trade markets meet the principles above in 5 to 10 years-time, from the CCP clearing perspective we suggest the following steps be taken:

Full implementation of the G20 mandate

In 5 to 10 years-time, the clearing obligation should be implemented for all eligible asset classes. This should include other asset classes than the ones currently being considered (e.g. commodities)¹⁴. The full implementation of the clearing obligation would lead to safer and more stable EU post-trade markets.

Harmonised rules and standards

EACH Members believe that fostering the harmonisation of rules and standards is essential to eliminate costly barriers (e.g. Giovannini barriers) and reduce complexity for investors and companies.

In 5 to 10 years from now, the EU post-trade markets should be such that cross-border barriers preventing the development of integrated European markets are fully dismantled. We note that significant fragmentation still exists in the public domain, e.g. in securities law, insolvency law, accounting standards for SMEs and tax procedures (e.g. withholding tax procedures) and investment fund services.

Efficient supervision

In the experience of EACH Members, the current system of supervision of EU CCPs through the EMIR college architecture functions generally quite well. It represents an innovative system of supervision that aims to match the benefits of regulatory convergence and local knowledge. While EACH agrees with the European Commission's impact assessment of the EMIR 2.2 legislative proposal¹⁵ that the current system of colleges established by the EMIR legislation to supervise EU CCPs needs some improvements, as expressed in our previous responses to public consultations¹⁶, we believe these improvements can be achieved without a complete

¹⁴ <https://www.esma.europa.eu/regulation/post-trading/otc-derivatives-and-clearing-obligation#title-paragraph-1>

¹⁵ http://eur-lex.europa.eu/resource.html?uri=cellar:80b1cafa-50fe-11e7-a5ca-01aa75ed71a1.0001.02/DOC_1&format=PDF

¹⁶ <http://www.eachccp.eu/wp-content/uploads/2016/04/EACH-response-to-EC-public-consultation-on-CMU-20150520.pdf>

overhaul of the existing supervisory regime for EU CCPs in order to make it sound, efficient, transparent, proportional and convergent.

We believe that certain improvements can be made to the current EU supervisory framework of CCPs that would contribute to better meeting those principles. Whatever form the EU supervisory framework takes, we believe that it should have the following characteristics:

- **Clear role and accountability of regulators** - To clearly define the **role and accountability of each regulator** (national competent authorities, ESMA, etc.) in the supervisory process. Further clarity is needed with regard to the supervisory responsibilities of the institutions to ensure clear accountability. In addition, a clear coordination between authorities is also needed.
- **Clear procedure and criteria** – To provide a clear procedure and criteria across different EU jurisdictions with regard to the approval of new products and services. In this sense the ESMA Opinion 'ESMA/2016/1574'¹⁷ was helpful in addressing several concerns.
- **Proportionality** (See comments in the next section 'Proportionality')
- **Safeguards** for CCPs - Further transparency is needed with regard to the decision-making process and procedure for CCPs to appeal authorities' decisions. Clear safeguards for CCPs are needed and should be developed against the disproportionate or wrongful exercise of the powers of authorities.
- **Target reviews** - In case of a new service or activity, the assessments by the competent authorities should be targeted and specific to those elements of an additional service or activity which are new to that service or activity.
- **No overlapping assessment** – The assessments currently performed by some regulators lead to the repetition of assessment which may not be directly related to the improvement proposed and which had already been approved by authorities during the original article 17 authorisation (i.e. during the authorisation of the CCP). An improved supervisory architecture should ensure that this type of repetition does not happen.
- **Level playing field** - EACH members believe that a proportionate and consistent process for the authorisation of new products and improvement of risk models should apply to all CCPs. An unclear and lengthy approval process could particularly put some CCPs at a disadvantage when trying to expand their activities.

<http://www.eachccp.eu/wp-content/uploads/2015/07/EACH-response-to-European-Commission-consultation-on-EMIR-review-August-2015.pdf>

¹⁷ https://www.esma.europa.eu/sites/default/files/library/2016-1574_-_opinion_on_significant_changes_for_ccps.pdf

Proportionality

In 5 to 10 years from now, the regulation and supervision of EU post-trade markets should aim to ensure a balanced level of effectiveness and proportionality. While it is important that EU authorities, in line with international standards, set the right level of requirements to guarantee a safe EU post-trade market, it is also crucial that in considering additional requirements, authorities apply a certain degree of proportionality.

Proportionality is particularly important in the **CCP clearing industry**, where substantial differences exist between the volumes and types of products being cleared and the markets served by different CCPs. These differences are to a certain extent quantified in the public quantitative disclosure information that CCPs make publicly available and the can be accessed through the EACH website <http://www.eachccp.eu/cpmi-iosco-public-quantitative-disclosure/>

As indicated in our feedback to the European Commission on the proposal for a regulation on 'Further amendments to the European Market Infrastructure Regulation (EMIR)¹⁸, we believe that proportionality is of especial important with regard to **CCP supervision**. The EU supervisory architecture should be proportional to the activities, financial instruments cleared and size of the CCP being supervised.

This proportionality element is of particular importance if the EU Supervisory architecture was to consider additional supervisory requirements to the ones included in EMIR. The treatment of members of the supervisory body (either CCPs colleges or single authority), should be equal (i.e. no authority should be given more than one vote). Furthermore EACH members believe that proportionality rules are needed in the structure of CCP colleges. We think that the competent authority should be part of the college structure only if clearing members have significant contributions to the CCPs default funds and they should not be part of the college in the case where the contributions of clearing members are minor or insignificant to the system.

The differences between EU CCPs should also be taken into consideration in relation to the cost related to the supervision. We would propose that EU Supervision should be proportional to the activities, financial instruments cleared and size of the CCP.

Measures to be taken to improve the cross-border flow of collateral

Following the recent financial crises, market participants faced a significant increase in the use of collateral to secure operations (e.g. operations with central banks, margin requirements, reverse repo transactions). In the next 5 to 10 years, EU post-trade markets should ensure the optimal use of collateral. This could be achieved by **targeting one single pool of collateral** which allows real time substitution. Cross border solutions will allow banks to have one single pool of collateral.

¹⁸ <http://www.eachccp.eu/wp-content/uploads/2017/10/EACH-feedback-European-Commission-proposal-%E2%80%98Further-amendments-to-the-European-Market-Infrastructure-Regulation-EMIR%E2%80%99-October-2017.pdf>

The implementation of European legislation and other non-legislative initiatives aimed at harmonising settlement across the EU helps improve the cross-border flow of collateral. Examples are the **CSD Regulation and the T2S project**. Both will facilitate settlements across CSDs and ICSDs, fostering greater financial integration.

We support the development of tools which allow collateral optimisation, such as **triparty repo solutions**. Triparty repo transactions, for which post-trade processing (e.g. collateral selection, payment and settlement, custody and management during the life of the transaction) is outsourced by the parties to a third-party agent, have the advantage to allow for real time substitutions and optimisation regarding the type of collateral delivered.

Lastly, we support the **ECB decision in May 2014 to remove the repatriation requirement**, part of Correspondent Central Banking Model ("CCBM"). This decision made it easier for Eurosystem counterparties to use assets, held as collateral at their domestic CSD, for their Eurosystem credit operations. The removal of the repatriation requirement eliminated the need to move assets from the investor securities settlement system ("SSS") to the issuer SSS in CCBM operations. We would encourage all EU central banks to embrace this solution.

Improving the legal enforceability of collateral and close-out netting arrangements cross-border

Financial Collateral Legislation

In the next 5 to 10 years, we would support a **Financial Collateral Harmonising Regulation as a long term aim, with convergence of existing practice under the Financial Collateral Directive as a medium term aim**. The key issue is to ensure that collateral arrangements are easily enforceable whether they are on the basis of title transfer or a security interest (and irrespective of the jurisdiction where the collateral is held and the jurisdiction of the grantor). The Financial Collateral Directive is useful in that regard. In order to improve legal enforceability of collateral (which supports effective risk management and efficient markets), we would welcome (in the long term) a review of the Financial Collateral Directive to make sure it is still fit for purpose, particularly in relation to cross-border arrangements. An alternative would be the introduction of a European legal framework for the harmonisation of rules regarding the methods allowing for effective acquisition of securities and collateral interests therein and the regime regarding good faith acquisition, building on the Financial Collateral and Settlement Finality Directives. This could include looking at the different types of security interest which exist under the law of different jurisdictions and ensuring there is a harmonised position on how such security interests are taken. It could also encompass some of the ancillary arrangements which surround collateral arrangements.

For example, we understand that powers of attorney are automatically revoked on the insolvency of the grantor in some jurisdictions but not in others.

It has also been observed that even 'netting-friendly' jurisdictions may have inconsistent laws regarding:

- (i) the scope of eligible parties allowed to use close-out netting: for instance, insurance companies or special purpose vehicles used by banks in the context of securitisation might or might not be netting-eligible, depending on the jurisdiction;
- (ii) the eligible types of contracts: jurisdictions differ, for instance, in their assessment of whether physically settled derivatives should be netting-eligible; and the extent to which close-out netting is compatible with the *pari passu* principle: for instance, the applicable regime regarding knowledge by the solvent party of the approaching insolvency of the counterparty differs across different jurisdictions.

**Q6: a) Do you agree that there are fewer barriers for cross-border provision of clearing and settlement services and processes than 15 years ago? Please explain.
b) If you agree that certain barriers have been removed, for each of those please explain what were the main drivers removing those barriers?**

As a participant in the drafting of the EPTF report¹⁹, EACH agrees with the assessment of the barriers that have been dismantled as included in that report ('Giovannini barriers' 2, 4, 5, 6, 7) and those that are yet to be dismantled ('Giovannini barriers' 1, 3, 8, 9, 10, 11, 12, 13, 14, 15 and the newly identified 'EPTF Barriers' 3, 4, 5, 6 and 10).

Q7: a) Which of the below issues listed by the EPTF as remaining barriers constitute a barrier to post-trade? Please select from the list.

- 1. Fragmented corporate actions and general meeting processes;**
- 2. Lack of convergence and harmonisation in information messaging standards;**
- 3. Lack of harmonisation and standardisation of Exchange Traded Funds (ETF) processes;**
- 4. Inconsistent application of asset segregation rules for securities accounts;**
- 5. Lack of harmonisation of registration and investor identification rules and processes;**
- 6. Complexity of post-trade reporting structure;**
- 7. Unresolved issues regarding reference data and standardised identifiers;**
- 8. Uncertainty as to the legal soundness of risk mitigation techniques used by intermediaries and of CCP's default management procedures;**
- 9. Deficiencies in the protection of client assets as a result of the fragmented EU legal framework for book-entry securities;**
- 10. Shortcomings of EU rules on finality;**
- 11. Legal uncertainty as to ownership rights in book-entry securities and third party effects of assignment of claims;**
- 12. Inefficient withholding tax collection procedures.**

¹⁹ https://ec.europa.eu/info/sites/info/files/170515-eptf-report_en.pdf

b) Are there other barriers to EU post-trade not mentioned in the above list? (In the second part of the questionnaire you will be asked to give more detailed views on those issues that you consider to be barriers.)

c) If there are issues that you think are not barriers, please explain why.

d) Please list what you consider to be the 5 most significant barriers.

Of the issues listed above, EACH believes that from a CCP clearing perspective and for the reasons identified in the EPTF dossier (except those expressed in the dissenting views), the following two issues constitute particularly important barriers:

- **Barrier 8 - Uncertainty as to the legal soundness of risk mitigation techniques used by intermediaries and of CCP's default management procedures**
- **Barrier 10 - Shortcomings of EU rules on finality**

Due to the importance of safe clearing industry to contain systemic risk, we believe that it is particularly urgent to address those two barriers.

- END -