

January 24, 2022

European Central Counterparty (EuroCCP) Response to ESMA's report on highly liquid financial instruments with regards to the investment policy of central counterparties (EMIR Article 85(3a(e)))

EuroCCP greatly appreciates the opportunity to provide comments in response to the ESMA report on highly liquid financial instruments with regards to the investment policy of central counterparties (CCPs). As the European Union scales its clearing capabilities it is important that European CCPs have access to all relevant risk management tools, including as it relates to which financial instruments are appropriate for CCP investments. Money Market Funds may indeed serve as a helpful risk-management tool provided they satisfy certain requirements related to, among other things, redeemability, registration, etc. More important, however, is that European CCPs attain adequate access to central banks, which greatly reduces market and credit risk and ultimately supports the attractiveness of European clearing.

CCP access to central banks, whether for purposes of deposits or liquidity, varies substantially across Europe. EuroCCP believes this patchwork not only creates an unlevel playing field, but also acts as an impediment to a fully realized Capital Markets Union (CMU). In order to support the CMU, enhance the risk management framework of the clearing process, and enhance the attractiveness of EU clearing at a time when the EU is seeking to increase its clearing capacity, EuroCCP respectfully encourages authorities to promote policies to:

- 1) Increase CCP access to central bank deposits
- 2) Extend TARGET2 hours
- 3) Explore whether CCPs have adequate access to central bank liquidity

We discuss these recommendations more fully below.

EuroCCP

EuroCCP is headquartered in Amsterdam and is one of the largest pan-European CCPs in Europe. In 2021, EuroCCP cleared over 1.7 billion transactions representing over 10 trillion EUR notional cleared. In addition to the 10,000 separate securities (equities and ETFs) cleared by EuroCCP across 18 countries and 47 trading platforms, EuroCCP has made significant investment in its operational capabilities and recently expanded its offering to include the clearing of exchange-traded equity options and futures.

Access to Central Banks

Deposits

We commend ESMA for considering additional instruments that may be suitable for CCP investment. The type of financial instrument appropriate for CCP investment is an important component of the CCP risk management framework. However, EuroCCP believes enhancing CCP access to central bank deposits, particularly with respect to non-EUR denominated cash collateral, would also have a significant, positive impact on the risk management framework.

ESMA rightfully notes that for CCPs “[t]he most secure form to hold cash remains in central bank accounts[.]”¹ ESMA also notes that “more than half of EU CCPs invest 90% of their financial resources in central bank deposits.”² This demonstrates a strong preference of CCPs to deposit cash with central banks in order to safeguard those assets. This is largely due to the fact that central bank deposits are highly liquid and help CCPs avoid commercial custodian/credit risk. Unfortunately, **European CCPs lack sufficient access to central banks.** A recent survey by the European Association of CCP Clearing Houses (EACH) identified a concerning number of CCPs in Europe that lack adequate access to central bank deposits or central bank liquidity.³ Where some respondent CCPs lack access to intra-day central bank deposits, others lack access to overnight central bank deposits. Of those CCPs that do have access to central bank deposits – whether intra-day or overnight – the vast majority of them do not have the ability to deposit cash in multiple currencies and are instead only allowed to make deposits in the domestic currency. EuroCCP believes it is important for European authorities to take concrete steps to increase CCP access **to the most secure method of holding cash collateral** – central banks.

Specifically, EuroCCP believes that CCPs should have the ability to deposit additional currencies with central banks intra-day and overnight – particularly USD. Simply put, increasing European clearing capacity necessarily means an increase in collateral collected. A portion of this collateral is today, and will continue to be, in non-EUR currencies. Again, as a central component of Europe’s risk management framework CCPs should have adequate and equal access to the most secure method of holding cash.

TARGET2

At the very least EuroCCP believes it is critical that TARGET2 hours are extended from 7:00 - 18:00 (CET) to 7:00 - 22:00 (CET). Clearing members can receive margin calls after 18:00 (CET) as trading platforms are open during this time. When this occurs it effectively prevents clearing members from meeting the margin call with EUR, even if the clearing members would normally prefer to meet margin calls with available EUR. Indeed, this is one reason why CCPs receive USD collateral in the first place—the inability of clearing members to send EUR after 18:00 (CET).

Moreover, once the CCP receives USD in satisfaction of an evening margin call, it is the responsibility of the CCP to safeguard the cash collateral. At this point in the day there tends to be fewer repo counterparties willing and able to transact. CCPs must then resort to purchasing other acceptable

¹ See The European Securities and Markets Authority. “Report on highly liquid financial instruments with regards to the investment policy of central counterparties (EMIR Article 85(3a(e))) (November 2021), at para. 62.

² *Id.* at para 37.

³ European Association of CCP Clearing Houses, *CCP Access to Central Bank Facilities* (December 2021), available at, <https://www.eachccp.eu/wp-content/uploads/2021/12/EACH-Note-on-CCP-access-to-Central-Banks-deposits-and-liquidity-December-2021.pdf>.

financial instruments or depositing the cash (unsecured) with commercial banks – each option bringing undesired and unnecessary risks.

Instead, as noted, we believe it would be prudent to extend the hours of TARGET2 to enable clearing members to more effectively make use of EUR for margin calls. Of course, regardless of the TARGET2 hours, there will remain occasion for CCPs to receive USD. Thus, we believe it would also be prudent to allow CCPs to deposit USD in central banks.

Liquidity

In addition to ensuring CCPs have adequate access to central bank deposits we encourage authorities to explore whether there are situations in which central banks should serve as potential sources of liquidity for CCPs. As previously noted, CCP access to central banks varies by jurisdiction. This patchwork framework acts as an impediment to a fully realized Capital Markets Union and may reduce certainty during extreme and extraordinary circumstances. Unexpected, extreme market events may arise that prevent CCPs from accessing liquidity from commercial entities. If this led to the inability of CCPs to provide clearing capacity to the marketplace this would, in all likelihood, exacerbate and prolong market turmoil. Exploring whether central bank should serve as a potential source of CCP liquidity helps ensure CCPs have adequate liquidity during extreme and extraordinary circumstances. Ultimately, this would bolster the resilience of the clearing system, in particular, and the health and safety of the financial system overall. As the EU supports the expansion of European clearing capacity and capabilities it is important that these black swan events are not overlooked.