



European Securities and  
Markets Authority

## **Response form for the Consultation Paper on central clearing solutions for pension scheme arrangements (EMIR Article 85(2))**



## Responding to this paper

ESMA invites responses to the questions set out in Annex II of the First Report with Consultation on Central Clearing Solutions for Pension Scheme Arrangements that ESMA drafted under Article 85(2) of the Regulation (EU) No 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories (EMIR, as amended by Refit).

### Responses are most helpful if they:

- respond to the question stated;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all responses received by 15 June 2020.

### Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

- Insert your responses to the questions in the Consultation Paper in the present response form.
- Please do not remove tags of the type <ESMA\_QUESTION\_CCSPSA\_1>. Your response to each question has to be framed by the two tags corresponding to the question.
- If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.
- When you have drafted your response, name your response form according to the following convention: ESMA\_CCSPSA\_nameofrespondent\_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA\_CCSPSA\_ABCD\_RESPONSEFORM.
- Upload the form containing your responses, in Word format, to ESMA’s website ([www.esma.europa.eu](http://www.esma.europa.eu) under the heading “Your input – Open consultations” → “Consultation on central clearing solutions for pension scheme arrangements”).

### Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly indicate by ticking the appropriate checkbox on the website submission page if you do not wish your contribution to be publicly disclosed. A confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA’s Board of Appeal and the European Ombudsman.



### **Data protection**

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading “Data protection”.

### **Who should read the Consultation Paper**

All interested stakeholders are invited to respond to this consultation paper. In particular, responses are sought from market participants, pension funds, banks, CCPs, central banks, authorities and trade associations of financial market participants.



## General information about respondent

Name of the company / organisation	Eurex Clearing, Deutsche Börse Group
Activity	Central Counterparty
Are you representing an association?	<input type="checkbox"/>
Country/Region	Germany

## Introduction

***Please make your introductory comments below, if any:***

<ESMA\_COMMENT\_CCSPSA\_1>

Eurex Clearing appreciates the opportunity to provide feedback to ESMA's consultation on central clearing solutions for pension scheme arrangements (PSAs). We agree in general with the described challenges and potential scenarios for PSAs around the access to collateral transformation services. However, we would like to highlight that the initial reason to grant PSAs an exemption from the clearing obligation has successfully been allayed by the introduction of an appropriate technical industry led solution, which provides PSAs with access to repo liquidity including under market stress scenarios for the purpose of cash variation margin (VM).

It is important to highlight as well that the Great Financial Crisis has underlined the importance of accurate risk management via central clearing. While many of the financial institutions are nowadays centrally clearing large parts of their OTC transactions, reducing systemic risk in line with the G20 commitments, the ongoing exemption from the clearing obligation for PSAs means that PSAs continue to be exposed to the risks of under-collateralization and potential defaults of their typically larger and more systemic trading counterparty – especially in light of the repeated delay of the phase-in of bilateral margin requirements. In contrast, central clearing would ensure proper collateralization of risks and would decrease the likelihood of public bail outs in case of any defaults. Therefore, an accurate assessment of the PSA exemption from the clearing obligation should not look at the costs of central clearing for PSAs in isolation – but should equally take into account the costs for pensioners resulting from failed risk management and potential defaults of PSA trading counterparts.

On the question of viable clearing solutions for PSAs, we are convinced that collateral transformation, in conjunction with access to central bank liquidity in periods of market stress, is already in place. Further improvement and refinements are ideally aligned with gathering experience with central clearing for PSAs. Eurex Clearing's proposal to address the issues explored in the consultation paper rests on three complementing pillars:

- PSAs can directly access centrally cleared OTC IRS and the established, highly liquid centrally cleared repo market via the EMIR compliant facilitated clearing model "ISA Direct" by Eurex Clearing in order to address clearing broker concentration, counterparty risk and repo market access concerns.
- Banks providing cash via the Eurex GC Pooling market with a German or Luxembourg banking license can already today directly re-use the received collateral automatically to re-finance those securities with the central bank.

- While we do not think that an emergency liquidity tool is neither necessary at this point in time, central banks should complement their existing bilateral money market operation and portfolio management capabilities by becoming direct participants of cleared repo systems allowing them higher flexibility and optionality to provide cash into the system in crisis situations either in a more (capital) efficient manner to intermediaries, allowing them to net repo and reverse repo transactions against central banks and the “street” or potentially directly to PSAs should the central bank see the necessity to address potential systemic risks.

Furthermore, liquidity of the centrally cleared repo market has been reliable over the last 15 years. Even in times of market stress, EU repo markets have been particularly resilient – during the Great Financial Crisis in 2008, the European sovereign debt crises during 2011-2012 and most recently during the COVID-19 crisis. As reported by ICMA ERCC in its recent semi-annual survey and special report on the European Repo Crisis during the COVID-19 crisis in April 2020, European centrally cleared repo markets are of significant size (EUR 8,310.3 billion) and provided ample liquidity to market participants during extreme volatility. While buy-side firms have been successful in managing their liquidity needs on the centrally cleared repo market through the early part of March, the volatility and associated cash movements and requirements were challenging to manage in bilateral markets.

Additionally, it should be noted that an increased participation of investment funds, in particular, European Money Market (EU MMF) funds, insurance and corporates as traditional cash providers to the centrally cleared repo markets will likely further increase the availability of cash via cleared repos in the future.

Moreover, PSAs do not have to adjust their investment strategy when accessing the CCP cleared repo market and centrally clearing OTC IRS. In fact, it is conceivable that their cash quota could be reduced, investment returns increased, and operating costs reduced given the improved access to bank balance sheets, more competitive pricing and higher operational efficiency offered by CCP cleared repos. Therefore, we are convinced that the centrally cleared repo market is best suited to provide a cost effective and reliable solution for PSAs.

Some European PSAs already make use of facilitated clearing access models to access the liquid cleared repo market. We believe that a natural - though timely - phase-in of the clearing obligation would allow to gather further experience and improve the set-up of the industry solution outlined above.

In this context, the currently limited take up of new CCP membership models in Europe can be attributed to various factors. For example, we have observed some hesitance from clearing members to support facilitated clearing memberships like Eurex Clearing’s ISA Direct due to implementation costs. However, legal certainty that the clearing obligation will apply to PSAs in the near future will justify the investments on clearing member side and will likely increase the number of firms offering these new models. Against this background, we think that there will be a significant take up of facilitated direct CCP memberships from both Clearing Agents and PSAs and other buy-side entities in the future mirroring developments in the US.

Another factor to facilitate the uptake of new facilitated CCP membership models might be to address the current regulatory framework which does not always take into account the risk reducing nature of CCPs as well as the continued postponement of uncleared margin rules which should have acted as an incentive to clear.

Against this background, Eurex Clearing recommends exploring additional regulatory measures to increase the attractiveness of centrally cleared repos for PSAs and the buy-side in general:

- Capital rules (CRR/CRD) require enhancements to reflect the role of Clearing Agents providing access for buy-side firms to CCP direct access models and clarify the treatment of pre- and unfunded default fund contributions, as well as default management obligations in the leverage ratio and risk weight exposure calculations. This would help facilitate the use by buy-side firms (pension funds, insurance undertaking or asset managers) of direct access models which were specifically designed to address their concerns with central clearing;

- Pension funds (or insurers) which are direct members of CCPs via direct access models should also be allowed to benefit under Solvency II from the same preferential treatment that are given to clearing members under CRR II (i.e. look-through criteria for clients);
- Counterparty limit of 15% per counterparty for EU MMFs and 20% for UCITS/AIF should include a specific treatment for CCPs with a higher threshold to avoid breaching these limits too fast given the 'central' role of the CCP;
- UCITS/AIFs that have received collateral via title transfer in an SFT should be allowed to pledge back this collateral to the provider of the collateral as long as the collateral is held bankruptcy remote from the initial collateral provider;
- UCITS should be allowed to net exposures arising from centrally cleared derivatives and securities financing transactions for the calculation of counterparty risk limit;
- UCITS should be permitted to raise cash via repos in order to meet margin calls from centrally cleared derivatives;
- Non-financial counterparts are important cash providers, as such cash collateral provided from those corporates for banks via the CCP should not be treated less favourably than cash collateral being provided to them via bilateral relationships.

To conclude, the discussion on the exemption for PSAs from the clearing obligation should factor in that (a) established solutions are available for adoption; such adoption, which has been slow to date, will likely increase with a clear direction from regulators and a defined end-date for the exemption and (b) the fact that PSAs effectively phase-in their clearing activity by clearing new business only, which will build the full exposure only over a longer period of time. The possibility to extend the exemption by one year twice should only be used as a last resort.

Eurex Clearing trusts that our comments are seen as a useful contribution to the assessment of viable central clearing solutions for PSAs and the exemption from the clearing obligation and remain at the disposal of ESMA for any questions and additional feedback.

<ESMA\_COMMENT\_CCSPSA\_1>



**Q1 : Do you agree with the description made of the portfolios of EU pension funds as well as their use of derivatives? In particular, do you agree that PSAs use derivatives to build synthetic long-dated positions in order to overcome the availability of suitable sovereign or corporate bonds alternatives? Please elaborate on the reasons for your answer.**

<ESMA\_QUESTION\_CCSPSA\_1>

Yes, we agree that the lack of issuance of long dated high-quality bonds restricts the ability of EU pension schemes in general to manage the interest rate risks adequately. Nevertheless, using OTC IRS offers additional benefits relative to bonds as OTC IRS allows more accurate cash flow matching, simplifies necessary hedge ratio adjustments over time and frees up cash.

<ESMA\_QUESTION\_CCSPSA\_1>

**Q2 : Do you have any data with respect to the structure of PSAs' portfolios? In particular regarding the duration gap which derivative strategies are designed to address?**

<ESMA\_QUESTION\_CCSPSA\_2>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CCSPSA\_2>

**Q3 : Do you have any data on the volume and nature of the activity of PSAs in cleared and non-cleared OTC derivatives markets, within each asset class, and any related systemic risk they might pose to the financial system? What portion of non-cleared derivatives would be replaceable by cleared products if the impediments to clearing were removed?**

<ESMA\_QUESTION\_CCSPSA\_3>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CCSPSA\_3>

**Q4 : Do you think that PSAs fulfilling the clearing requirement would have significant consequences on their investment strategies, including any shift in their cash and non-cash asset allocation? Please elaborate on the reasons for your answer and provide numerical data supporting your answer where available.**

<ESMA\_QUESTION\_CCSPSA\_4>

The report provides a good summary of potential scenarios should PSAs have concerns about access to cash transformation services. However, as reported by ICMA ERCC in its recent semi-annual survey and special report on the European Repo Crisis during the COVID-19 Crisis in April

2020, European centrally cleared repo markets are of significant size (EUR 8,310.3 billion) and provided ample liquidity to market participants during the extreme volatility. Some European PSAs, notably Insight Investment and PGGM, already have access to the liquid CCP cleared repo market. Therefore, we believe that PSAs would not need to adjust their investment strategy or cash quota were they to clear OTC IRS centrally and access the CCP cleared repo market. In fact, it is conceivable that their cash quota could be reduced, investment returns increased, and operating costs reduced due to the improved access to bank balance sheet, more competitive pricing and higher operational efficiency offered by CCP cleared repos.

<ESMA\_QUESTION\_CCSPSA\_4>

**Q5 : Are there further considerations, other than investment strategies mentioned above, either driving or constraining the use of derivatives for PSAs?**

<ESMA\_QUESTION\_CCSPSA\_5>

The well documented concentration of clearing brokers offering clearing services for OTC IRS, in particular for large clients with directional positions such as PSAs, could indeed increase the cost of interest rate hedging for PSAs as clients, may lead to concentration risk concerns and could limit their capacity to hedge with OTC IRS. However, some of these issues are not unique to CCP cleared transactions and exist as well in the bilateral world. For example, operational and credit risk considerations already limit the number of banks executing 30 or 40 yearlong OTC IRS with PSAs bilaterally.

To mitigate these concerns, Eurex Clearing has developed a clearing model (ISA Direct) which specifically addresses the aforementioned challenges without requiring a substantial deviation from the typical central cleared processes by a PSA. Through the ISA Direct clearing model, PSAs are able to limit costs of clearing without participating into the loss mutualization process and are no longer subject to the bottleneck effect of concentrated banks providing client clearing. From a macro-prudential perspective, (facilitated) direct access models also help reduce concentration risks and enhanced segregation and portability making a valuable contribution to strengthen the resilience of the overall financial system in crisis situations. Of course, given their good credit quality, PSA could also become full clearing members at CCPs alternatively to the described facilitated direct access models.

<ESMA\_QUESTION\_CCSPSA\_5>

**Q6 : Do you agree with the description of the challenges met by PSAs to post variation margin in cash? Please elaborate on the reasons for your answer.**

<ESMA\_QUESTION\_CCSPSA\_6>

Yes, we agree with the depiction of the challenges. However, as explained in our answer to question 4, we believe that there is sufficient evidence that, by accessing the centrally cleared repo market, PSAs could mitigate the highlighted collateral transformation/cash management concerns for extreme but plausible market stress scenarios





<ESMA\_QUESTION\_CCSPSA\_6>

**Q7 : Do you have any data with respect to the value and/or share of cash holdings in PSAs' portfolios? Can you provide estimates of how much those would need to be increased to service cash variation margin calls?**

<ESMA\_QUESTION\_CCSPSA\_7>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CCSPSA\_7>

**Q8 : Do you have any data with respect to estimated changes in variation margin for your outstanding contracts for a +/- 1% parallel shift in the yield curve for: a) cash VM of centrally cleared contracts, b) cash VM for OTC contracts, c) bonds VM for OTC contracts, and d) for all your outstanding contracts?**

<ESMA\_QUESTION\_CCSPSA\_8>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CCSPSA\_8>

**Q9 : Can you provide data on the prevalence of acceptance of non-cash collateral in the context of bilateral OTC trades? And conversely on the limitations imposed by counterparties to post initial margins in the form of cash?**

<ESMA\_QUESTION\_CCSPSA\_9>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CCSPSA\_9>

**Q10 : Can you provide data on the size of the yield drag from holding cash buffers to service variation margin calls in cash? Possibly differentiating between drag from under-investment and costs of funding temporary high liquidity demands?**

<ESMA\_QUESTION\_CCSPSA\_10>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CCSPSA\_10>



**Q11 : Are you (or are you aware of) a PSA which is a direct clearing member to a CCP? How have you addressed the issues regarding the posting of cash VM?**

<ESMA\_QUESTION\_CCSPSA\_11>

Yes, for example PGGM Treasury B.V. is a Basic Clearing Member at Eurex Clearing under the aforementioned ISA Direct clearing model and allows PGGM to centrally clear repos. Intraday and end of day margin calls can be met by pledging securities (9,000 ISINs) out of PGGM's own CSD account. There is no cash variation margin (VM) requirement due to the very short tenors of CCP cleared repos.

<ESMA\_QUESTION\_CCSPSA\_11>

**Q12 : Can you indicate whether you have considered becoming a direct clearing member to a CCP for the purpose of clearing mandated contracts? If not, what were the reasons against becoming a direct member? Specifically, were there other considerations beyond the issue of cash variation margins?**

<ESMA\_QUESTION\_CCSPSA\_12>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CCSPSA\_12>

**Q13 : Do you agree that the central clearing of OTC derivatives by PSAs by June 2023 at the latest is the ultimate aim? Do you agree that the entry into force of this requirement should be subject to regulatory and market developments enabling market participants to develop appropriate technical solutions within that period? Please elaborate on the reasons for your answer.**

<ESMA\_QUESTION\_CCSPSA\_13>

Yes, we believe that the current exemption elapsing in June 2021 allows sufficient time for PSAs to set up their clearing arrangements as they would in fact phase-in their clearing activity by clearing new business only. The possibility to extend the exemption by one year twice should only be used as a last resort. It is important to note that despite the fact that viable solutions have been developed since the exemption to PSAs had been granted the progress for adopting these solutions and ensuring readiness has been limited. Therefore, a defined end-date for the exemption will likely facilitate the focus on the readiness process.

The Great Financial Crisis has underlined the need for accurate risk management by a neutral and independent third party, i.e. CCPs. The G20 Pittsburgh agreement was made against the background that CCP markets navigated through the crisis in a stable manner and withstood systemic shocks. In this context, it is important to highlight that – while many of the financial institutions are nowadays centrally clearing large parts of their OTC transactions, meaning that the systemic risk has been reduced significantly – the ongoing exemption for PSAs means nothing less than that their risk management is still carried out within their own institution, often involving

conflicts of interests and typically leading to an underpricing of risk, but also to the potential default of typically larger and more systemic counterparties.

In order to reap the benefits of central clearing with regard to reducing counterparty risk to the fullest extent possible, we would hence strongly recommend against any further delays to the implementation of the clearing obligation. On the questions of the existence of viable sources of repo liquidity in market stress scenarios for the purpose of cash VM, we believe that the initial reason to grant PSAs an exemption from the clearing obligation has successfully been allayed by the introduction of appropriate technical industry led solution to the greatest possible extent. A further exemption of this relevant user group is therefore unsubstantiated and will disincentivize and postpone all efforts from the industry to take the necessary readiness steps.

Indeed, a continued reliance on the uncleared world, especially in light of the recent delay of the phase-in of bilateral margin requirements as part of the COVID-19 crisis relief measures, pension funds continue to be exposed to counterparty credit risk and remain undercollateralized. Moreover, in light of the repeated delay of the Uncleared Margin Rules, we would like to bring to ESMA's attention that bilateral margining for uncleared contracts acts as an incentive to clear by making this option more expensive for pension funds compared to central clearing. The suggestion that central clearing would be costly implies that uncleared contracts use weaker risk management standards, thereby exposing pension funds to the bilateral risk of bank failure, including the costs of replacing contracts in the event of a default.

Comparatively, central clearing would ensure proper collateralization for the risks undertaken by PSAs and their respective trading counterparts, and as such would decrease the likelihood of public bail outs in case of any defaults. An accurate assessment of the situation should not look at the costs of central clearing for PSAs in isolation – but should equally assess the potential costs for pensioners that would be caused by failed risk management and subsequent partial or total default resulting from a large OTC counterpart failing. While national supervisors may have a tight grip on the risk models used by their pension funds, they do not necessarily have a view on the other counterparties which have entered in an OTC transaction with the PSA. As the clearing obligation is a two-way street, it means that PSAs are today exposed in the bilateral world to the potential default of typically larger and more systemic counterparties.

This is important to understand from a political and regulatory perspective, given that a serious crisis situation in relation to PSAs would have dramatic social consequences with a high number of pensioners potentially losing big parts or all of their benefits. Therefore, an accurate assessment should weigh the costs of central clearing against the costs of failed risk management and a default of a PSA trading counterpart – especially because the financial crisis revealed that not only banks but also insurers and fund/asset managers were in severe difficulties and required public bailouts. It will be critical to ensure that the lessons from the financial crisis have been learnt – and that sustainable growth and a furthering of the prosperity of society is fundamentally based on financial stability and integrity.

Collateral transformation in conjunction with access to central bank liquidity in periods of market stress is already in place and can be further improved. Eurex Clearing's proposal to the issues raised by the PSAs rests on three complementing pillars:

- PSAs can directly access centrally cleared OTC IRS and the established, highly liquid centrally cleared repo market via the EMIR compliant ISA Direct clearing model in order to

address clearing broker concentration, counterparty risk and repo market access concerns.

- Banks providing cash via the Eurex GC Pooling market and a German or Luxembourg banking license can already today directly re-use the received collateral automatically to re-finance those securities with the central bank.
- Central banks should complement their existing bilateral money market operation and portfolio management capabilities by becoming direct participants of cleared repo systems allowing them higher flexibility and optionality to provide cash into the system in crisis situations either in a more (capital) efficient manner to intermediaries, allowing them to net repo and reverse repo transactions against central banks and the “street” or potentially directly to PSAs should the central bank see the necessity to address potential systemic risks.

Additionally, it should be noted that an increased participation of investment funds, in particular, European Money Market Funds (EU MMF), insurance and corporates as traditional cash providers to the centrally cleared repo markets will likely further increase the availability of cash via cleared repos in the future.

In this context, PSAs, investment funds and insurances can be set-up as Basic Clearing Members at Eurex Clearing and trade centrally cleared repos in the long-established Pan-European and BaFin regulated Eurex repo market, with more than 160 participants including:

- financing agencies, e.g. Germany, Netherlands;
- supranationals, e.g. ESM, EIB, EFSF as well as
- central banks, e.g. SNB, Central Bank of Malta, Central Bank of Luxembourg.

The market has proven to be resilient during significant market events (e.g. Lehman default, the European sovereign debt crises and the current COVID-19 crisis) and actually saw increased trading volumes.

We believe that the above solution effectively addresses many of the issues raised by PSAs, reduces counterparty and settlement risks and improves market access across the whole universe of stakeholders. Some European PSAs already make use of direct clearing access models to access the liquid CCP cleared repo market. From Eurex Clearing’s perspective the natural phase-in allows to gather experience and re-calibrate and improve the set-up over time, but it is important again to define a strict timeline to ensure continued progress.

<ESMA\_QUESTION\_CCSPSA\_13>

**Q14 : In the hypothetical scenario where the exemption were to be made permanent, do you think that there would be a price handicap for less-liquid non-cleared contracts vis-à-vis the cleared alternatives? Can you provide estimates of the size of the price differential and the impact, also in terms of yield drag on PSA portfolios?**

<ESMA\_QUESTION\_CCSPSA\_14>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CCSPSA\_14>

**Q15 : Under the new regime provided in EMIR Refit with respect to the scope of application of the clearing obligation and the calculation of the positions, do you expect to be or not subject to the clearing obligation once the clearing exemption has come to an end?**

<ESMA\_QUESTION\_CCSPSA\_15>

While this question is in general addressed to pension funds, we would like to provide our view on the impact of the new calculation method for the clearing thresholds. Eurex Clearing has welcomed the introduction of the clearing obligation for OTC derivatives under EMIR as one of the key cornerstones of the G20 reforms in the aftermath of the financial crisis and supports ESMA in its efforts to further specify the conditions and procedures for making the clearing obligation provisions applicable. We also acknowledge the aim of EMIR REFIT to relieve smaller market participants from unnecessary burden and understand the introduction of small financial counterparties (FC-) as part of this attempt. The overarching rationale when granting or extending exemptions should always be to strike the balance between thoroughly implementing G20 objectives and justified proportionality to cater for the needs of the smallest counterparties.

We welcome that the regulators introduced a clearing threshold for financial counterparties with a view to ensure proportionality for FC-. The clearing threshold for FCs was aligned on the existing clearing threshold for NFCs - set for IRD, FX & Commodities at €3bn and for CDS & Equity at €1bn. By introducing a minimum floor to the clearing obligation, EMIR REFIT provides a healthy balance between the aspiration to reduce potentially disproportionate costs and burdens for the smallest financial counterparties, whilst safeguarding the objectives of the G20 OTC derivatives markets reforms as key volumes/notional amounts are still subject to the clearing obligation. By aligning the clearing threshold for FC- and NFCs, EMIR REFIT also supports sound risk management principles: risk mainly stems from the type of activity conducted rather than from the type of legal entity – it therefore ensures a level playing field.

Therefore, we would expect that the new threshold, based on an aggregate month-end average calculation for the previous 12 months, would allow the smallest pension funds to be exempt from central clearing, ensuring a proportionate approach to the risk they chose to engage. Unfortunately, in the meantime, while we note that these smallest pension funds would likely have to continue exchanging VM under the UMR, they would likely fall below the IM threshold, further decreasing the proper collateralization of their exposures.

However, we would like to use this opportunity to highlight to ESMA that, while all other financial counterparties have to calculate their positions at group level, AIFs/UCITs can do so at fund level as long as it does not lead to “(i) a systematic underestimation of the positions of any of the funds they manage or the positions of the manager; and (ii) a circumvention of the clearing obligation”. Thus, national competent authorities (NCAs) have a key role in assessing and checking the positions of the FC, being entitled to ask a fund manager to demonstrate that the calculations of its positions at the fund level does not lead to the risks mentioned above.

We are convinced that the combination of assessing thresholds on the fund level and defining thresholds on notional rather than on a risk basis significantly under-estimates the risk relevance inherent in the portfolios not subject to the clearing obligation, not only taking the FC- as counterparts, but more importantly their dealer counterparts into account.

We believe that these conditions around the threshold calculation lack clarity and create questions as to whether the intentions of the policy-makers to have only a limited and targeted group of FC-be exempt from the clearing obligation are respected. We are in particular concerned that the fund level calculation of the new threshold (instead of an aggregate level e.g. asset manager) will lead to these entities falling out from central clearing, though on a trading layer, they behave as one entity (through block trading across multiple funds).

This could have serious negative implications for the overall systemic risk and broader financial stability, not only via the bilateral market dimension but also because any clearing ecosystem needs a healthy balance between “fixed payers” and “fixed receivers”. Funds (including pension funds) in particular, play a vital role in this context, as those are the key entities seeking long-dated exposures. Taking this significantly growing market segment out of the equation would lead to a systemic build of up risk by resulting in a systematic imbalance. In this context, we also note that the EU is lagging behind if benchmarked at global level, as other jurisdictions have included such entities in the clearing ecosystem for a long time already.

We would therefore call on ESMA and the NCAs to carefully monitor the pick-up of clearing rates by the asset management sector in the EU and assess whether the current methodology to determine clearing thresholds is appropriately calibrated to ensure appropriate clearing levels and a balanced clearing ecosystem.

<ESMA\_QUESTION\_CCSPSA\_15>

**Q16 : Do you agree with the pre-conditions for a workable solution as described in paragraph 51? Please elaborate on the reasons for your answer.**

<ESMA\_QUESTION\_CCSPSA\_16>

Yes, we agree that a solution needs to be both cost effective and reliable. As pointed out in our answer to question 4, there are sufficient data points demonstrating the robustness and liquidity of the euro-denominated CCP cleared repo market over the last 15 years.

<ESMA\_QUESTION\_CCSPSA\_16>

**Q17 : Are there any other features that the solution should try and achieve?**

<ESMA\_QUESTION\_CCSPSA\_17>

In our opinion, the solution should not only fulfill the pre-conditions set up in paragraph 51. Ideally, the solution should also provide auxiliary benefits, e.g. CCP cleared repos improved settlement efficiency, offers counterparty risk mitigation and standardizes the legal framework.

<ESMA\_QUESTION\_CCSPSA\_17>

**Q18 : Do you agree with the statement that no or few PSAs were onboarded with the status of clearing members, but instead clear as direct clients of a clearing**



**member? Do you think that this situation may evolve in the coming years? Please elaborate on the reasons for your answer.**

<ESMA\_QUESTION\_CCSPSA\_18>

Yes, to our knowledge only a limited number of European PSAs are a direct member of a CCP, e.g. PGGM or Insight Investment managed entities. However, we think that there will be a significant take up of direct CCP memberships from PSAs and other buy-side entities in the future mirroring developments in the US. For example, DTCC FICC offers central clearing of repos to buy-side entities since 2005. Today, more than 1,900 individual buy-side entities are connected. In Europe, Eurex Clearing has been spearheading the development of appropriate clearing models which permits buy-side entities to access the centrally cleared OTC IRS, repo and securities lending market.

We believe that more PSA's will be encouraged to join CCPs as clearing members, as more CCPs design specific types of clearing licenses tailored to the needs of buy-side clients.

Eurex Clearing has developed the ISA Direct clearing model which opens up a new principal client relationship between buy side clients and the CCP, with the regular clearing member acting as a clearing agent covering the default management obligations including the default fund contribution and optionally certain clearing services such as transaction, cash or collateral management. Through ISA Direct, PSAs are able to limit costs of clearing without participating into the loss mutualization process and are no longer subject to the bottleneck effect of concentrated banks providing client clearing.

As explained in question 13, via the EMIR compliant ISA Direct clearing model of Eurex Clearing PSAs, investment funds and insurances can be set-up as Basic Clearing Members at Eurex Clearing and directly access centrally cleared OTC IRS and the established, highly liquid centrally cleared repo market, addressing clearing broker concentration, counterparty risk and repo market access concerns.

The limited take up of new CCP membership models in Europe can be attributed to various factors. For example, we have observed some hesitance from clearing members as OTC IRS clearing brokers to support facilitated clearing memberships like Eurex Clearing's ISA Direct. due to implementation costs. However, legal certainty that the clearing obligation will apply to PSAs in the near future will justify the investments on clearing member side and will likely increase the number of firms offering these new models. Hence, we believe that there will be a significant take up of direct CCP memberships from PSAs and other buy-side entities in the future.

Another factor hampering the uptake of new CCP membership models might be an unfavorable regulatory framework which does not always take into account the risk reducing nature of CCPs (e.g. same counterparty limit for CCP as counterparty than for any other counterparty, prohibition of re-use of cash to meet cash VM for UCITs – please also refer to our answer to question 21), as well as the continued postponement/amendment of uncleared margin rules which should have acted as an incentive to clear. In addition, the low capital market volatility has reduced urgency to address collateral management challenges.

<ESMA\_QUESTION\_CCSPSA\_18>

**Q19 : Do you agree that relying on collateral transformation services already offered by clearing members to their direct clients may be part of the solution? Please elaborate on the reasons for your answer.**

<ESMA\_QUESTION\_CCSPSA\_19>

Yes, in general it is part of the solution mix. However, as only CCP cleared funding solutions offer the ability of multilateral netting from a leverage ratio point of view, non-CCP cleared fund of PSAs by clearing brokers will invariably have a leverage ratio impact. In particular taking the refinancing option of the intermediary via a central bank into account, it is important to note that this can only be achieved in a capital efficient manner, if the central bank transaction can be included in the multilateral netting set which would require participation of the central bank in the cleared repo environment – please compare also Q13.

<ESMA\_QUESTION\_CCSPSA\_19>

**Q20 : To what extent has the constraint on the bank clearing members' capital requirements been eased and now allows for their role of collateral transformation to be better fulfilled?**

<ESMA\_QUESTION\_CCSPSA\_20>

The recently revised CRD V/CRR II package amended the leverage ratio to recognize the exposure reducing effect of margins posted by clients to clearing members, providing for some relief with regards to cleared derivatives transactions. These targeted amendments to the leverage ratio were then adopted at the international level ensuring a level playing field in June 2019. However, ECAG would advise against extending these amendments to the non-cleared space to safeguard the backstop function of the leverage ratio. We note that multilateral netting provided by CCPs in particular for repo transactions provides the basis for highly capital efficient transactions provided that more counterparts ideally including central banks would join the cleared repo markets.

<ESMA\_QUESTION\_CCSPSA\_20>

**Q21 : Do you think that modifying the calculation of the leverage ratio might have an impact on the offer on repo intermediation activities by banks and be a part of the solution? Please elaborate on the reasons for your answer.**

<ESMA\_QUESTION\_CCSPSA\_21>

Yes, it can be expected that reducing the leverage ratio impact of a securities financing transactions (SFT) may increase the availability of repo to PSAs. However, Eurex Clearing is also concerned that any further changes to the leverage ratio could limit its function as a backstop to excessive leverage building. The opposite of which financial regulators have been trying to achieve since 2008.



Instead, EU regulators should consider providing additional regulatory incentives and clarifications to increase the attractiveness of centrally cleared repos for banks, PSAs and buy-side in general in order to ensure increased PSA (buy-side) participation. Cleared repo markets will likely also increase the diversity of market participation and might reduce over time the dependency of a few large bank market participants.

Eurex Clearing would recommend the following regulatory changes to incentivize clearing for the buy-side more broadly:

- Capital rules (CRR/CRD) require enhancements to reflect the role of Clearing Agents providing access for buy-side firms to CCP direct access models and clarify the treatment of pre- and unfunded default fund contributions, as well as default management obligations in the leverage ratio and risk weight exposure calculations;
- Pension funds (or insurers) which are direct members of CCPs via direct access models should be allowed to benefit under Solvency II from the same preferential treatment that are given to clearing members under CRR II (i.e. look-through criteria for clients)<sup>1</sup>;
- Counterparty limit of 15% per counterparty for EU MMFs and 20% for UCITS/AIF should include a specific treatment for CCPs with a higher threshold to avoid breaching these limits too fast given the 'central' role of the CCP;
- UCITS/AIFs that have received collateral via title transfer in an SFT should be allowed to pledge back this collateral to the provider of the collateral as long as the collateral is held bankruptcy remote from the initial collateral provider;
- UCITS should be allowed to net exposures arising from centrally cleared derivatives and securities financing transactions for the calculation of counterparty risk limit;
- UCITS should be permitted to raise cash via repos in order to meet margin calls from centrally cleared derivatives;
- Non-financial counterparts are important cash providers, as such cash collateral provided from those corporates for banks via the CCP should not be treated less favourably than cash collateral being provided to them via bilateral relationships.

<ESMA\_QUESTION\_CCSPSA\_21>

**Q22 : Can you elaborate on issues you have encountered, or risks you perceive, in relying of clearing members to provide collateral transformation services, including transformation into cash to meet variation margin requirements? Is this a service that is available to you? If not, what are the obstacles?**

<ESMA\_QUESTION\_CCSPSA\_22>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CCSPSA\_22>

**Q23 : What is your view on solutions based on collateral transformation via the repo market? Do you think that initiatives on collateral transformation solutions via**

---

<sup>1</sup> The calculation of counterparty default risk with the standard formula would apply Article 192 (3) of Delegated Regulation (EU) 2015/35, as amended by Article 1 (44) of Delegated Regulation (EU) 2019/981.

**the repo market constitute one possible solution? What other solutions are worth exploring?**

<ESMA\_QUESTION\_CCSPSA\_23>

As explained in our previous answers, e.g. answer to questions 4 and 13, the centrally cleared repo market has provided constant liquidity during the Great Financial Crisis in 2008, the European sovereign debt crises during 2011-2012 and most recently during the Corona virus induced shocks. During these periods of extreme volatility in equity markets, CCP cleared repo rate change were negligible and volumes increased. Therefore, we think that this the very best market-based solution. Of course, central banks could provide liquidity directly to PSAs, but this would most likely crowd out commercial banks and may create moral hazard.

Against this background, we would like to reiterate our answer to question 13. Collateral transformation in conjunction with access to central bank liquidity in period market stress is already in place and can be further improved. Eurex Clearing's proposal to the issues raised by the PSAs rests on three complementing pillars:

- PSAs can directly access centrally cleared OTC IRS and the established, highly liquid centrally cleared repo market via the EMIR compliant ISA Direct clearing model in order to address clearing broker concentration, counterparty risk and repo market access concerns.
- Banks providing cash via the Eurex GC Pooling market and a German banking license can already today directly re-use the received collateral automatically to re-finance those securities with the central bank.
- Central banks should complement their existing bilateral money market operation and portfolio management capabilities by becoming direct participants of cleared repo systems allowing them higher flexibility and optionality to provide cash into the system in crisis situations either in a more (capital) efficient manner to intermediaries, allowing them to net repo and reverse repo transactions against central banks and the "street" or potentially directly to PSAs should the Central Bank see the necessity to address potential systemic risks.

Additionally, it should be noted that an increased participation of investment funds (in particular, EU MMFs), insurance and corporates to the centrally cleared repo markets.

In this context, PSAs, investment funds and insurances can be set-up as Basic Clearing Members at Eurex Clearing and trade centrally cleared repos in the Eurex Repo market, which includes:

- financing agencies, e.g. Germany, Netherlands
- supranationals, e.g. ESM, EIB, EFSF
- central banks, e.g. SNB, Central Bank of Malta, Central Bank of Luxembourg

<ESMA\_QUESTION\_CCSPSA\_23>

**Q24 : Do you think that the repo market is suitable for PSAs' needs? If not, what are the impediments for PSAs to access the repo market? Please elaborate on the reasons for your answer, specifying if these are related to cost, operational complexities or regulatory constraints.**



<ESMA\_QUESTION\_CCSPSA\_24>

Yes, the repo market is suitable for PSA's needs. Given the depth and liquidity of EU repo markets, Eurex Clearing believes they are suitable to help PSAs with their liquidity needs. Even in times of stress, EU repo markets have been particularly resilient and supported other types of financial counterparties perform their VM payment smoothly. See our answer to questions 13 and 23 for example.

<ESMA\_QUESTION\_CCSPSA\_24>

**Q25 : Do you have any data with respect to PSAs' potential liquidity demand in business-as-usual? Also, do you have any data with respect to PSAs' maximum liquidity needs in stressed market conditions?**

<ESMA\_QUESTION\_CCSPSA\_25>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CCSPSA\_25>

**Q26 : Do you think that PSAs fulfilling their liquidity needs via the repo market will have strong implications on this market's liquidity and procyclicality? Can you provide quantification of the risk of the likelihood of a failure of market-based repo solutions to meet PSAs' needs? Under which conditions?**

<ESMA\_QUESTION\_CCSPSA\_26>

We do not expect any significant procyclicality or liquidity issue. The existing CCP cleared repo market is dominated by commercial banks, although supranationals, financing agencies and some central banks participate from a portfolio management point of view. Despite the relatively uniform participation types, liquidity has been reliable over the last 15 years. The ICMA survey on the European repo market and ECB Money Market statistics over the last years provide detailed information in this regard. The special COVID-19 ICMA report of April 2020 shows that cleared repo markets were again resilient though non-cleared markets appeared stressed in parts. Buy-side firms have been successful in managing their liquidity through the early part of March. However, the volatility and associated cash movements and requirements were challenging to manage in bilateral markets.

Instead of shrinking, EU cleared repo markets act as safe-havens and usual witness an increase of volumes in times of crisis. Based on the experience, Eurex Clearing concludes there is little reason to believe such markets would be subject to liquidity squeezes or have pro-cyclical repercussions.

Of course, should extreme political events lead for example to the unlikely breakup of the Eurozone or European Union significant market stress could be expected which then could limit the ability of PSAs to manage cash. However, financial crises over the decade in the Eurozone resulted in short-term falls in high quality government bond yields and swap rates. Both of which would increase the cash available to PSAs.

<ESMA\_QUESTION\_CCSPSA\_26>

**Q27 : Do you think that there is agreement or evidence that the impact of the limitations of the solutions explored so far would be such that there is a need for devising and developing some form of emergency liquidity tools? If so, under which scenarios and how could such tools actionably and realistically be deployed?**

<ESMA\_QUESTION\_CCSPSA\_27>

We do not think that an emergency liquidity tool would be necessary at the start of the clearing obligation for PSAs. However, we believe that EU regulators should consider improving certain aspects of the regulatory framework in order to achieve a broad-based buy-side participation similar to that observed today at DTCC FICC. Please see our answer to question 21 for concrete proposals for additional regulatory incentives, such as for example addressing the issues of same counterparty limits for EU MMFs and UCITS/AIFs for CCP as counterparty than for any other counterparty, or the prohibition of re-use of cash to meet cash VM for UCITs.

Additionally, central banks should consider the option to provide capital efficiency liquidity to intermediaries via the cleared repo markets or directly via the cleared repo market to PSAs in extreme emergency situations. As outlined some central banks already have access to the cleared repo markets so it would not require any major additional infrastructure, but solely technically and legally connecting to a trading and clearing environment to have the option to act in emergency situations in an orderly manner.

<ESMA\_QUESTION\_CCSPSA\_27>

**Q28 : In the hypothetical scenario where central banks extended liquidity support to PSAs, can you provide estimates of the costs, also in terms of infrastructure, ancillary requirements, and regulatory obligations that this option would entail? Can you express the cost in term of yield drag on PSAs performance, especially vis-à-vis the null option of increasing cash allocation in PSAs' investment portfolios?**

<ESMA\_QUESTION\_CCSPSA\_28>

As outlined before, we believe that setting-up for the optionality to provide liquidity directly or indirectly to PSAs via the cleared repo market should be rather straight forward and require limited investment.

In that context, it may be reasonable to provide an estimate on the costs of using centrally cleared repos vs. bilateral repos from a PSA perspective. Due to the decrease in interest rates over the last decade many PSAs currently have significant positive cash balances which is the positive mark to market they received from their bilateral OTC IRS (VM). PSAs tend to invest cash received as VM short-term as unsecured deposits or through purchases of securities/MMFs outright or by non-CCP cleared reverse repos.



The recently established risk-free interest rate for the Eurozone (€STR) is a good estimator at which PSAs can deposit overnight with commercial banks on unsecured basis, currently at around -54bps.

The STOXX GC Pooling Deferred Funding Rate is the centrally cleared reverse (repo) rate benchmark at which PSAs could invest or borrow cash at against a broad-based set of high-quality ECB eligible securities (14,000 ISINs) and which currently is approx. -48bps.

Hence, the spread between the unsecured deposit rate and the CCP cleared (reverse) rate is approx. 5.5bps, i.e. it is more attractive to invest cash in CCP cleared reverse repos than in unsecured bilateral deposits on average.

Since most PSAs today do not access the CCP cleared repo market, moving to a CCP cleared reverse repo could immediately result into an improved investment return and risk profile for any cash balance.

Equally, PSAs could raise cash at the STOXX GC Pooling Deferred Funding rate on a short-term basis. Compared to EONIA, the STOXX repo rate was on average approx. 3.9bps lower since 2010. Therefore, PSAs could also reduce their cost of short-term funding by utilizing the CCP cleared repo market relative to bilateral markets. As eluded to previously, the CCP cleared repo market as provided liquidity on a reliable basis over the last 15 years.

Of course, PSAs would need to consider implementation and maintenance costs for this solution. However, the historically observable interest rate benefit from centrally cleared reverse (repos) should help buffering the impact.

<ESMA\_QUESTION\_CCSPSA\_28>

**Q29 : What type / form of emergency liquidity tools do you think could be deployed? And whom should they be accessible to? In particular, is there any tool other than central bank liquidity that you would recommend to ESMA to consider?**

<ESMA\_QUESTION\_CCSPSA\_29>

We do think that an emergency liquidity tool is neither necessary nor recommendable. However, we would advocate that national central banks and/or the ECB conduct their market operations as direct clearing members at CCPs. This would greatly improve the transmission of monetary policy relative to the current bilateral environment as commercial banks could borrow cash from the central bank via CCP and lend out the cash to PSAs connected to the CCP on a leverage neutral basis. Via that approach central banks would secure the optionality to provide cash via the cleared repo market eventually directly to PSA should central bank deem it appropriate and necessary in an emergency situation to address any potential systemic stability risk.

<ESMA\_QUESTION\_CCSPSA\_29>