ESRB
European Systemic Risk Board
European System of Financial Supervision

Commissioner Mairead McGuinness
European Commission
Rue de la Loi / Wetstraat 200
1049 Brussels
Belgium

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ESRB view on the targeted EMIR review with respect to central clearing in the EU

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Dear Commissioner McGuinness, dear Mairead,

I am writing to you with reference to the view that the European Systemic Risk Board (ESRB) has developed on the targeted review of the European Market Infrastructure Regulation (EMIR)[1]. In particular, the ESRB has given consideration to (i) measures to increase the attractiveness of central clearing in the European Union (EU) and to strengthen supervision, setting out proposals in this letter for improving the current central counterparty (CCP) tiering framework; and (ii) measures to address over-reliance on, and excessive exposures to, third-country (TC) CCPs. This contribution is a follow-up to the opinion the ESRB shared with you on 22 March 2022 as a response to the European Commission consultation[2].

This letter, together with its appendix and the March response to the European Commission consultation, constitutes the view of the ESRB. Therefore, these documents should be read together. The proposals presented here were reviewed by the ESRB's Advisory Technical Committee and Advisory Scientific Committee, and the final letter was agreed by the ESRB General Board in a written procedure on 18 July.

[1] **Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.7.2012, p.1)**.

[2] **ESRB response to the European Commission targeted consultation on the review of the central clearing framework in the EU**.

They mostly take the form of high-level proposals, and the ESRB stands ready to develop them further should the European Commission wish.

Context

In the light of the European Commission's intention to publish legislative and non-legislative proposals for amending EMIR so as to (i) increase the attractiveness of EU clearing and (ii) to strengthen the supervisory framework for EU CCPs, the ESRB would like to take this opportunity to put forward proposals that could strengthen the current tiering framework for TC CCPs.

The ESRB is of the opinion that the proposed changes to the current CCP tiering framework could help fine-tune the tiering structure. This would allow a more accurate assessment and provide a better reflection of each TC CCP's systemic relevance. In addition, referring to its letter to the European Commission dated 22 March 2022, the ESRB proposes measures and tools to address the over-reliance on substantially systemic (currently "Tier 2+") TC CCPs and/or clearing services in certain currencies, to the extent that these clearing services pose financial stability risks.

The ESRB developed its view in consultation with the European Securities and Markets Authority (ESMA).

Overarching view of the ESRB

In the ESRB's view, building on the recent experience of the recognition of UK CCPs and those established in other third-country jurisdictions, the overall approach to the assessment and recognition of TC CCPs could benefit from refinements so that it better reflects the underlying criteria for determining the classification of TC CCPs. The ESRB does not propose that the current tiering system should be overhauled completely. Instead, the suggested changes concern the structure of the tiering framework and the frequency of reviews, together with the way the underlying criteria are taken into consideration, which should allow for more professional judgement and flexibility in the tiering framework. In addition, the ESRB agrees that over-reliance on TC CCPs, particularly those in the substantially systemic category (currently "Tier 2+", but Tier 3 in our proposal) might create financial stability risks. The ESRB suggests three possible measures to reduce these risks. Finally, the ESRB makes some additional proposals to further support the strengthening of the EU framework for central clearing and to help the migration of clearing volumes to the EU. These additional proposed measures are aimed at mitigating financial stability risks and may indirectly create incentives to move volumes to the EU.

The ESRB submits these proposals for the consideration of the European Commission in the context of the targeted EMIR review. Some of the proposals can also be addressed through amendments to delegated regulations. The appendix to this letter provides more detailed information.

Amendments to the CCP tiering structure

The current CCP tiering structure set out in EMIR for TC CCPs specifically considers only Tier 2 CCPs and some areas are covered only implicitly. Any TC CCP that does not meet the criteria for a Tier 2 CCP is either not systemically important enough to be subject to specific measures beyond the conditions for recognition set by the Commission (Tier 1) or is too systemically important (Tier 2+). In addition, TC CCPs which do not apply to be recognised are not considered relevant at all, even though they might provide EU clients with clearing services. The ESRB proposes developing the current tiering framework into a more transparent and refined tiering framework for TC CCPs that features four categories, ranging from Tier 0 (not recognised) to Tier 3 (substantially systemic CCP). Each of these categories comes with its own review frequency, so that reviews are more frequent for CCPs that are considered more systemic.

The determination of the category should take into consideration both quantitative and qualitative criteria as well as professional judgment and should be based on all the criteria listed in EMIR.[3] Currently, most tiering determinations are performed exclusively on the basis of the quantitative indicators specified in Article 6 of Commission Delegated Regulation (EU) 2020/1303 (the Tiering DA)[4]. Besides improving the current quantitative indicators (e.g. by adding exposures in non-EU currencies), consideration could be given to amending the Tiering DA in a way that also gives some weight to the qualitative indicators mentioned in EMIR as a complement to the quantitative indicators. This would leave room for other legitimate (financial stability) considerations that are not yet covered by the quantitative indicators; it would also take into account the ESRB opinion on tiering even if the quantitative thresholds are not breached. In addition, when determining systemic relevance, the assessment should consider not only systemic relevance at the EU level but also systemic relevance at the Member State and/or currency level. In the latter case, the national competent authority should assess systemic relevance for the Member State in question and take appropriate measures.

The ESRB considers that these changes would result in a clearer, consistent structure which better reflects the systemic relevance certain TC CCPs have for the EU or one or more of its Member States. This is a necessary starting point for further work on making EU clearing more attractive and moving clearing business to the EU, which would result in decreased financial stability risks.

[3] Article 25(2a) of EMIR lists five criteria, which are set out in further detail in the Tiering DA. The Tiering DA then adds four quantitative indicators to be used to exclude CCPs that are automatically considered Tier 1.

[4] **Commission Delegated Regulation (EU) 2020/1303 of 14 July 2020 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to the criteria that ESMA should take into account to determine whether a central counterparty established in a third country is systemically important or likely to become systemically important for the financial stability of the Union or of one or more of its Member States (OJ L 305, 21.9.2020, p. 7)**.

Measures and tools to reduce exposures to TC CCPs and/or to clearing services in currencies that have been determined to be of substantial systemic importance.

To help reduce exposures to TC CCPs and especially targeting those clearing services in currencies that are causing the Tier 3 status, the ESRB envisages three options that could be used on a stand-alone basis or in conjunction with one another. As a credible alternative to derecognition, the Tier 3 status of a TC CCP should at least entail exposure reduction measures. The measures and tools in question have also been suggested in the ESRB response that we shared with the European Commission in March of this year, and we give further details of them in this letter. Applying any of these options (or similar ones targeting exposure reductions) will require further assessment as to the benefits, risks and (unintended) consequences associated with them. This further assessment should take into account (i) the global nature of markets in which transactions are subject to a central clearing obligation, (ii) the risk diversification function of centrally cleared derivatives and (iii) the fact that many of the transactions currently subject to clearing in TC CCPs involve non-EU counterparties that might hesitate to shift clearing from their current location.

In principle, a reduction in exposures induced by legislative measures could be achieved by adapting the large exposures regime in the Capital Requirements Regulation (CRR)[5] to clearing members' exposures to substantially systemic TC CCPs. This could be done by amending the Pillar 1 treatment of qualified CCPs or by using Pillar 2 capital charges, which would be easier to implement and offer greater flexibility than fixed exposure limits.

Beyond legislative interventions, a reduction in exposures to substantially systemic CCPs might be achieved by setting Tier 3 TC CCP exposure reduction targets agreed between EU clearing members and their supervisors. The two measures could be combined: reduction could be voluntary in the first instance, with the prospect of the clearing members being subject to mandatory supervisory measures if the voluntary approach is not sufficient. In any case, these approaches require a prudent assessment of the targets that can be achieved without damaging EU clearing members' access to the risk diversification gains associated with global derivatives trading.

Finally, the step of making it mandatory for EU counterparties to have active account at an EU CCP, possibly paired with incentives to clear volumes of the products that are considered of substantial systemic importance through these EU CCPs' accounts, could help encourage the flow of clearing volumes towards

[5] **Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1)**.

the EU. It could also substantially reduce the operational risk of a cliff-edge scenario in which EU entities are abruptly cut off from clearing services provided by TC CCPs[6]. This option could also be combined with (one of) the first two measures. Nevertheless, the potential unintended consequences of introducing such a measure – for example the risk that EU clearing members and clients may be put at a competitive disadvantage – should be carefully assessed.

Other suggestions

Other, more technical changes, such as extending the clearing obligation to more asset classes, making the use of an EU CCP mandatory in situations where both counterparties are located in the EU and providing clarity on the interoperability for derivatives, might help create a more robust and attractive EU clearing landscape and attract volumes to the EU market for central clearing. Before any of these measures are implemented, they would need to be carefully assessed with regard to their potential benefits, risks and (unintended) consequences, such as competitive (dis)advantages.

Publication

The ESRB will publish this letter, including its appendix, after it has been sent to the European Commission.

Yours sincerely,

Francesco Mazzaferro

Head of the ESRB Secretariat

Encl.

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[6] This measure might be more suitable for house accounts but rather difficult to implement with regard to client business, as clients typically choose the CCP when buying a derivative and have the possibility of changing clearing members. They can therefore use a non-EU clearing member for clearing at a TC CCP. Separating house and client business into two CCPs reduces hedging possibilities.

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Appendix
ESRB view on the targeted EMIR review with respect to central clearing in the EU

Note

on the targeted EMIR review with respect to central clearing in the EU

1. Background

As a follow-up to the European Systemic Risk Board (ESRB) response to the European Commission targeted consultation on the review of the central clearing framework in the European Union (EU), the ESRB would like to provide suggestions for improving the European Market Infrastructure Regulation (EMIR)[7] legislative framework. In the light of the European Commission's intention to publish proposals for a review of EMIR later this year, the ESRB has decided to provide the European Commission with its suggestions in good time, before the actual proposals are published. The special focus will be on measures to achieve the two objectives stated by the European Commission, namely (i) increasing the attractiveness of clearing at EU central counterparties (CCPs) and (ii) strengthening the supervisory framework for CCPs.

In addition to building on the previous ESRB response as mentioned, this note refers back to the (non-public) ESRB opinion on the draft of Commission Delegated Regulation (EU) 2020/1303 (the Tiering DA)[8], which concerns the tiering of third-country (TC) CCPs. The note contains an additional proposal for minor amendments to the current tiering framework for TC CCPs. This proposal covers several areas, starting with the

[7] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.7.2012, p.1).

[8] Commission Delegated Regulation (EU) 2020/1303 of 14 July 2020 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to the criteria that ESMA should take into account to determine whether a central counterparty established in a third country is systemically important or likely to become systemically important for the financial stability of the Union or of one or more of its Member States (OJ L 305, 21.9.2020, p. 7).

tiering framework for TC CCPs, with specific measures suggested in some instances. The ESRB stands ready to provide more detailed proposals and/or quantitative underpinning at the European Commission's request.

2. The tiering framework for TC CCPs

The CCP tiering framework was designed to classify TC CCPs in terms of size and risk and determine whether a particular TC CCP is systemically important or likely to become systemically important for the financial stability of the EU or of one or more of its Member States.

The criteria for making this assessment, set out in EMIR and the Tiering DA, are as follows:

1) the nature, size and complexity of a CCP's business;
2) the effect of the failure of or a disruption to a CCP;
3) the CCP's clearing membership structure;
4) alternative clearing services provided by other CCPs;
5) the CCP's relationship, interdependencies, or other interactions;
6) indicators of minimum exposure of clearing members and clients established in the Union to the CCP.

Depending on the outcome of the assessment, a CCP is either systemically important or likely to become systemically important for the financial stability of the EU or of one or more of its Member States (Tier 2 CCP) or it is not (Tier 1). If the CCP is categorised as Tier 2, a further assessment must be made to determine whether the CCP or some of its clearing services are of such substantial systemic importance that that CCP should not be recognised for the provision of certain clearing services or activities (this category of CCP is informally known as Tier 2+). Each tiering category is managed under its own supervisory set-up.

The recent market turmoil in the commodities markets has made it clear that Tier 1 CCPs can also be a cause for great concern for market participants in the EU. The market circumstances suggest that this is an opportune moment to consider an evaluation of the current CCP tiering framework set out in EMIR. For instance, LME Clear, the clearing house of the London Metal Exchange, was classified as a Tier 1 CCP based on the quantitative thresholds provided in the Tiering DA, but the recent stressed market conditions made it obvious that developments at the London Metal Exchange and LME Clear were having a great impact on EU counterparties and there was little (possibility for) involvement of EU authorities, given the classification of LME Clear as a Tier 1 CCP. The reason why developments at LME and LME Clear had such a large impact on EU counterparties was that the EU and UK commodities markets are strongly interconnected and highly concentrated, with a small number of large financial institutions acting as a clearing member for a large number of energy companies. The risks were partially mitigated because the Bank of England and Financial Conduct Authority voluntarily reported on a daily basis to the European Securities and Markets Authority (ESMA) and to the national competent authorities (NCAs) that are members of LME Clear's global supervisory college.

However, the ESRB was not a part of this process. In this note, the ESRB proposes improvements to the current CCP tiering framework so that it better reflects the risks that TC CCPs might pose to the EU.

The potential problem is that, should a CCP be confronted with changes that might cause it to move to another tiering category, the supervisory set-up would no longer meet the requirements. The move from Tier 1 to Tier 2 is addressed in EMIR, which provides for an adaptation period of up to 18 months, with the possibility of extending this period by up to an additional six months.[9] Moving from one tiering category to another, with the regulatory and supervisory changes that this would entail, might prove challenging and require more time. EMIR does not provide any solutions for monitoring and mitigating risks in the interim period and there is no adaption period for CCPs moving from Tier 2 to Tier 1 or for CCPs moving from Tier 1 to Tier 0 in EMIR.

One way to address this is by extending the adaptation period (if it concerns a move from Tier 1 to Tier 2 and this move to another tiering level is justified but simply requires more time) or by having specific measures in place to reduce exposures to the TC CCP during an adaptation period (for instance if it concerns a move from Tier 2 to Tier 2+). Examples of measures that could be employed in the latter case are given further down in this note.

This note proposes amendments to the current tiering structure and the way the tiering levels are determined. It also proposes other measures that could (i) help to increase the attractiveness of EU clearing and (ii) help to move clearing volumes from TC CCPs to EU CCPs.

Tiering structure at the EU, Member State and currency levels

The four main changes proposed concern: (i) the introduction of official labels for two implicit tiering categories to accommodate (substantially) systemic CCPs; (ii) the introduction of tiering criteria for each Member State and/or currency and the inclusion of a client level; (iii) the frequency of the reclassification; and (iv) the weighting of the criteria.

Redefining the current tiering structure

Following the same set of criteria as is currently being used (i.e. the above-mentioned criteria set out in EMIR and the Tiering DA), the ESRB proposes acknowledging the implicitly existing tiering structure and introducing new labels for two of the (implicitly) existing tiering levels, i.e. Tier 0 (non-recognised) and Tier 3 (substantially systemic). In addition, it proposes that these tiering categories take into account the fact that risks might differ for each

[9] Article 25(5) EMIR.

Member State and currency. Systemic importance should therefore not only be determined at the EU level, but at the Member State and/or currency level as well. The aspect of systemic importance at the Member State level is already present in EMIR in the Level 1 text but not – or at least not explicitly – in the related Level 2 legislation. This would need to be amended to take into account the Member State perspective in the actual assessment that takes place at Level 2. The currency dimension is not emphasised in EMIR and would need to be enhanced in the Level 2 legislation.

Under these proposals, the tiering categories should apply both at the CCP level and at the clearing services level, as is currently the case.

Tiering category proposals	Description	Supervisory set-up for CCPs and potential measures	Supervisory set-up for clearing members
Tier 0 ***(new and implicit)***	CCPs that are NOT recognised by ESMA. This could be because these CCPs are not compliant, have not applied for recognition, have applied but have not yet been recognised, are located in non-equivalent jurisdictions, or a combination of the above.	Not supervised by ESMA or any other EU NCA One solution could be to introduce the US regime of recognition, where a TC CCP NEEDS to be registered as a Derivatives Clearing Organisation (DCO)[10] to provide services to any EU clients.	No clearing services to EU clearing members and trading venues. The EU cannot ban EU firms from clearing through these CCPs voluntarily (e.g. for local cash equities or futures), be it through local subsidiaries or as clients. However, there are disincentives in place, such as: • confirming they are not eligible to discharge the clearing obligation (as is currently the case); • additional capital charges on top of the Capital Requirements Regulation (CRR)[11] charge for

[10] Section 5b of the Commodity Exchange Act, Title 7 of the United States Code § 7a-1 and Part 39 of the Commodity Futures Trading Commission's (CFTC's) regulations. See also **the clearing organisations page on the CFTC website.**

[11] **Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1)**.

			exposures to non-qualifying CCPs (e.g. charges for exceeding credit and concentration limits) to force EU clients to build a cushion for the additional risk; charges to be determined on a product-by-product basis.
Tier 1	CCPs that are recognised by ESMA but where volumes at the EU, Member State or currency level are not of systemic relevance	CCP subject to home country supervision	EU clients can discharge the clearing obligation (as is currently the case)
Tier 2	CCPs that are recognised by ESMA but where volumes at the EU, Member State or currency level are of systemic relevance	CCP subject to ESMA and home country supervision (it is suggested that the set-up be expanded to include ongoing compliance with CCPs' requirements under the Recovery and Resolution Regulation (RRR)[12] (in addition to EMIR) and that the comparable compliance framework be adjusted)	EU clients can discharge the clearing obligation (as is currently the case)
Tier 3	CCPs and/or clearing services in currencies that are of substantial systemic importance (such that under Article 25(1) EMIR they might not be allowed to provide their clearing services from outside the EU). This would typically concern CCPs that have already been active in the EU and have developed into a substantially systemic CCP. If a CCP is placed in this category, it means that (i) the aim should	EMIR and the relevant Level 2 texts could provide for a gradual prudential response to Tier 3 CCPs. As a "first-best choice" solution, a set of measures could be put forward and implemented (whether alternatively or jointly) to reduce exposures to Tier 3 CCPs and to guarantee adequate supervisory and	During the transitional phase, EU clients can discharge the clearing obligation through these CCPs but may be subject to additional capital charges and/or other measures aimed at exposure reduction. In the case of derecognition as a last resort, EU clients would not be able to discharge the clearing obligation through

[12] Regulation (EU) 2021/23 of the European Parliament and of the Council of 16 December 2020 on a framework for the recovery and resolution of central counterparties and amending Regulations (EU) No 1095/2010, (EU) No 648/2012, (EU) No 600/2014, (EU) No 806/2014 and (EU) 2015/2365 and Directives 2002/47/EC, 2004/25/EC, 2007/36/EC, 2014/59/EU and (EU) 2017/1132 (Text with EEA relevance) OJ L 22, 22.1.2021, p. 1.

	be to reduce exposures to the CCP in order to bring it back to the Tier 2 category and (ii) additional supervisory or resolution guarantees should be obtained from the CCP and its TC supervisors; alternatively if these measures are not sufficiently effective, and subject to the outcome of a cost/benefit analysis, the CCP could be derecognised.	resolution arrangements from an EU standpoint, allowing the CCPs to be brought back to the Tier 2 category over an adaptation period. As a last resort, Tier 3 CCPs could be derecognised. In this case, the CCP would not be authorised to provide some or all of its clearing services in the EU, and the EU would require these clearing services to be relocated to a jurisdiction within the EU. Measures taken will be aimed at CCPs and at clearing members and clients.	Tier 3 CCPs and would be subject to non-qualifying central counterparty (NQCCP) treatment.

Application at the Member State and currency level and inclusion of the client level

The ESRB believes that even if the quantitative threshold for a TC CCP to be classified as systemically important at the EU level is not exceeded, the TC CCP might still be deemed systemically important for one or more individual Member States. Therefore, in order to avoid false negatives, and to allow a TC CCP's systemic importance to be considered at the Member State level, the Commission could – as a first option – consider introducing an additional set of thresholds aimed at assessing importance at the Member State level and calibrated according to the size and complexity of a Member State's financial system and the CCP user base in that Member State. As a second option, if a uniform set of thresholds were to be used for the sake of simplicity, the Commission could consider setting them at lower levels (possibly at a fraction of the EU-wide threshold). Otherwise, as at third option, thresholds could be expressed in relative rather than absolute terms (e.g. credit exposures of entities from a given Member State to a TC CCP as a fraction of these entities' total credit exposures to all CCPs) and be based on the ability of the entity to absorb losses. In any case, individual Member State thresholds would not be set in the Level 2 legislation, but instead the NCA would determine that a TC CCP was systemically important for its Member State based on the criteria found in the Level 2 text. This would mean there was a lower likelihood of filtering out a TC CCP that could in fact turn out to be a Tier 2 CCP owing to its systemic importance to one Member State, even if this came at the expense of exposing relatively more TC CCPs to a fully-fledged assessment. If a TC CCP were then determined systemically relevant at the Member State level, it would also be considered systemically relevant at the EU level. In addition, to future-proof the quantitative framework, the ESRB suggests that the Tiering DA could be adapted so that it is based on thresholds that also determine systemic relevance at the Member State level and include a methodology for periodically reviewing the levels at which thresholds are set.

Indicators should be designed and thresholds calibrated to reflect the perspective of individual Member States and currencies, not just the perspective of the TC CCP. For instance, Article 6 of the Tiering DA considers only the indicators of minimum exposure of clearing members and clients established in the EU to the CCP. This point is very important: Article 6 of the Tiering DA also considers only global exposures in all EU currencies combined, whereas large exposures of EU participants to the CCP in non-EU currencies could indicate a certain degree of systemic relevance.

The latter perspective is critical for comprehensively assessing the impact that a TC CCP has or can have on the financial stability of the EU or of one or more Member States. During the recent tiering exercise carried out with the two UK CCPs for instance, these TC CCPs only provided the estimated largest payment obligations that would be caused by the default of the two largest single clearing members, but in all EU currencies combined (and only then were these payment obligations broken down by individual EU currencies). It would have been very useful to have had an overview of the largest payment obligations in each of the different EU currencies separately, which would have helped to determine e.g. the severity of liquidity strains on the money markets of these individual currencies. Also, it was impossible to comprehensively assess the risk to financial stability of a given Member State, as the global direct and (in)direct credit exposures of both clearing members and clients from that Member State to a given CCP could not have been reliably obtained from the available data.

The thresholds could be formulated such that they are set in relative terms and not only in absolute terms; for instance, they could be set as a percentage of total exposures (as well as in terms of the absolute size of exposures) and should take account of the ability to absorb losses. Another example would be the size of the CCP's business (per currency and asset class), in particular as regards the elements of the assessment mentioned in Article 1(2) of the Tiering DA, compared with the overall size of the market for that currency and that asset class, in order to provide a full picture of the entity's systemic importance. By the same token, the average and peak aggregate daily values of incoming and outgoing EU and non-EU currency payments as well as the extent to which central bank money is used for settlement and payment, as mentioned in Article 2(2)(b) and (c) of the Tiering DA, could be related to the overall liquid resources of clearing members in individual EU and non-EU currencies. Similarly, actual and potential exposures to a TC CCP of clearing members and their clients from a given Member State may be relatively small for a large CCP, but the disruption in the functioning of that CCP may represent a significant threat to the financial stability of that Member State, especially where clearing members or their clients are also other systemically important institutions (O-SIIs). It would also appear that Recital (7) of the Tiering DA, which sets the stage for the assessment to be performed under Article 5 of the Tiering DA, should indicate how a disruption in the functioning of a TC CCP can affect the financial stability of the EU or one or more of its Member States through its direct links to EU-based financial market infrastructures, and appropriate indicators should be included to take these interdependencies into account.

Although the relevant data are difficult to gather, quantitative assessment should also consider exposures of EU clients, even when cleared by third-country clearing members. As regards Article 6(1)(c) of the Tiering DA, the indicator does not consider the exposures of EU clients to the applicant TC CCP if the clearing of the underlying trades is facilitated through a third-country clearing member, or a clearing member that is not part of a group subject to consolidated supervision in the EU. This could be an important aspect to consider, especially in cases where exposures of EU clients are concentrated in a small number of third-country clearing members (e.g. for the clearing of products not subject to the obligation under Article 4 of the EMIR). This client dimension, while being very relevant to determining systemic importance, does not seem to be sufficiently accounted for, in particular in the first stage of the assessment and especially for those Member States that do not host domestic providers of client clearing services.

To summarise, the ESRB would suggest:

1) **amending the thresholds set out in the Tiering DA such that:**
    a. **they take into consideration exposures at both the EU and Member State levels in order to determine systemic importance;**
    b. **they are calibrated to also reflect the perspective of individual Member States and currencies (not just the perspective of the EU and the TC CCP);**
    c. **they take into account exposures (including client exposures) to both EU and non-EU currencies, also taking the aspect of substitutability into consideration;**
2) **clarifying the Level 2 text such that classification is not an automatic outcome and such that it leaves room both for professional judgment, which should be exercised in a transparent manner, and for other factors such as the substitutability of markets (to address specific cases, e.g. LME Clear*).***

Periodic review

The classification of each TC CCP needs to be periodically reviewed. EMIR currently provides for a uniform review frequency of once every five years. However, the schedule for reviewing the classification of TC CCPs could be restructured such that reassessments are more frequent the higher the category and/or when certain indicators are breached. An advantage of such an approach would be that the tiering category would better reflect a TC CCP's systemic importance. A disadvantage could be that the review requires substantial resources and time, while it is uncertain how frequently or swiftly a TC CCP will change its tiering category between assessment periods. In addition, conducting the review too often may lead to uncertainty for EU market participants, especially when the tiering category is associated with stricter or more relaxed supervisory arrangements. An example of a suggested review schedule is provided in the table below.

Suggested review frequency per tiering category

Tiering category	Review frequency
Tier 0	Upon request

Tier 1	Once every five years or when certain indicators are breached (for example in the case of significant changes to clearing volumes)
Tier 2	Once every three years or when certain indicators are breached (for example in the case of significant changes to clearing volumes)
Tier 3	Annually

Application of criteria

Finally, the six criteria currently being used for the classification could also be reconsidered. In recent tiering exercises for Tier 1 CCPs, the minimum exposure thresholds as defined in Article 6(1) of the Tiering DA were the only factor in deciding whether a TC CCP was considered systemically relevant (Tier 2) or not systemically relevant (Tier 1). The ESRB believes that this methodology has serious shortcomings and recommends including qualitative criteria and professional judgment alongside quantitative criteria. This would allow a more in-depth assessment by ESMA and the ESRB and could lead to a situation where more TC CCPs were considered to be Tier 2. A provisional assessment of the current and potential classification can be found in the table at the end of this appendix, entitled “Classification of TC CCPs”.

In addition, the ESRB considers that notional and margin requirements should not be the only basis of the thresholds. The relationship between notional and actual risk exposure varies depending on the products in question. The margin requirements are also dependent on any cross-margining policies of the CCP, rather than simply actual riskiness of the instruments. The ideal metric would be the sensitivity of the portfolio (e.g. value at risk (VaR)). It is not certain whether such a sophisticated approach could work, and the data might be technically challenging to obtain, although CCPs sometimes publish aggregate sensitivities. Another metric could be the variation margin requirements. However, the right type of metric would also depend on the asset class concerned and would need careful consideration in the case of certain new asset classes.

Systemic importance to the EU and individual Member States can also depend on the exposures resulting from the clearing of transactions denominated in non-EU currencies. Article 6(1)(a) and (b) of the Tiering DA set the quantitative threshold for both open interest and total notional outstanding in terms of contracts denominated in EU currencies only. This is also the case for the indicator described in Article 6(1)(d), which refers to the payment obligation and should include both EU and non-EU currencies to correctly reflect the exposures of EU participants. The exposures of EU market participants in non-EU currencies are also relevant to the EU’s financial system, as seems to be implied by Article 6(1)(c) of the Tiering DA. This might be even more significant as EU market participants normally do not have direct access to the central banks of issue for these non-EU currencies. In this respect, when EU market participants have large exposures to a TC CCP with a dominant position, for instance in USD-denominated products (e.g. commodities such as oil or natural gas), this CCP could still be deemed systemically important even if it conducts limited or no business in EU currencies, provided that the credit exposures of clearing members and their clients from one or more Member States are sufficiently large in relation to the loss-absorbing capacity of those entities and that those entities' defaults might disrupt financial stability.

Note on the framework for equivalence and comparable compliance

The concept of comparable compliance in the current framework is defined in both the Level 1 and Level 2 legislation (with respect to the Level 2 legislation, see Commission Delegated Regulation (EU) 2020/1304 on comparable compliance[13]). It does not include an assessment of the recovery and resolution arrangements, but the use of recovery and/or resolution tools by a TC CCP or its authorities might have a significant impact on the TC CCPs' risk profile and level of comparable compliance. The ESRB suggests amending Commission Delegated Regulation (EU) 2020/1304 to take this into consideration as one of the criteria for granting comparable compliance. The comparable compliance framework should also take into consideration the quantitative requirements set by Regulatory Technical Standards (RTS) 152/2013[14] and 153/2013[15], which have a particular impact on a CCP's risk profile.

Moving between tiering categories

The classification of the TC CCP could change. If circumstances were to change and/or if a third-country jurisdiction were declared (non-)equivalent and its CCP (de)recognised, the CCP would be reclassified and would move between categories. There could be cases where this process is less smooth or where circumstances lead to situations in which a certain CCP's tiering classification is no longer a proper reflection of the risk that the CCP poses to the financial stability in the EU. One example would be where a Tier 0 CCP grows too large and too systemically important not to have some form of (in)direct supervisory involvement from the EU and does not wish to apply for recognition in the EU. A second example would be where a Tier 1 CCP grows into a Tier 2 CCP, but the home authority will not allow direct supervision by ESMA. A third would be where a Tier 2 CCP becomes a Tier 3 CCP, but relocation is not a feasible option, so exposure

[13] **Commission Delegated Regulation (EU) 2020/1304 of 14 July 2020 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to the minimum elements to be assessed by ESMA when assessing third-country CCPs' requests for comparable compliance and the modalities and conditions of that assessment (OJ L 305, 21.9.2020, p. 13).**

[14] **Commission Delegated Regulation (EU) No 152/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on capital requirements for central counterparties (OJ L 52, 23.2.2013, p. 37)**.

[15] **Commission Delegated Regulation (EU) No 153/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on requirements for central counterparties (OJ L 52, 23.2.2013, p. 41)**.

reduction measures are needed or, as a last resort, the CCP's recognition to provide clearing services in the EU should be refused.

In cases such as the above, the framework needs to accommodate ways to address the resulting risks of these "category breaches" without the possibility of immediately changing the supervisory set-up. One possible way of addressing these risks might be to redirect volumes to other CCPs during an adaptation period, leading to diversification. In some situations, a denial of recognition to provide clearing services might be counterproductive. However, volume-linked incentives or disincentives, which could increase non-linearly to the deviation from the norm, could provide a solution and nudge the market in the desired direction.

The possibility of derecognising a Tier 3 CCP under Article 25(2c) of EMIR should be maintained. Although there could be a risk to the financial stability of the EU if such a CCP (or part of it) were abruptly derecognised, and the ongoing possibility of such a derecognition might lead to uncertainty in the financial markets, derecognition is provided for as a last resort under Article 25(2c) of EMIR, and this provision should be maintained as a way to provide an incentive for a Tier 3 CCP (and its clearing members) to take the appropriate steps to return to Tier 2 or to address the financial stability issues arising from substantially systemic TC CCPs in case they do not take those appropriate steps. The ESRB assessment carried out in 2021 concluded that for the time being, the direct involvement of ESMA in the supervision of Tier 2 CCPs, together with constant efforts to reduce the extreme exposures of the EU27 to the UK CCPs' clearing services in currencies that have been determined to be of substantial systemic importance, appears to be the best outcome for financial stability.

As a credible alternative to derecognition, the Tier 3 status of a TC CCP should at least entail the adoption of exposure reduction measures that must be applied during an adaptation period following determination of the TC CCP's Tier 3 status. EMIR could thus provide a set of "first-best choice" risk reduction measures aimed at bringing the CCP back to Tier 2. The use and calibration of such measures, and the way in which they were combined, would be determined on a case-by-case basis after a cost-benefit assessment, with due consideration of the value of preserving the access of EU clearing members to the risk diversification gains associated with global derivatives trading and in recognition of the possibility that non-EU clearing members may not voluntarily shift their activities to EU CCPs.

In this respect, it is worth considering whether any potential exposure reduction measures should be aimed at the CCP as a whole or solely at those clearing services that are considered to be of substantial systemic importance. In addition, if a reduction in exposures is not achieved despite the implementation of capital charges, other measures might also be called for. Any excessive risks associated with exposures to a Tier 3 TC CCP and/or its clearing services would also partially be mitigated by the capital charges, as these make clearing members/banks more resilient.

In summary, the amendments to the framework that the ESRB proposes consist of (i) defining more clearly the current set-up of the categories that determine the level of supervisory engagement and the situation with regard to the clearing obligation and (ii) using tools to deal with breaches or excessive risks. For instance, when a Tier 2 CCP becomes a Tier 3 CCP, measures should be triggered to properly contain the increased risks. The following paragraph describes some of these proposed measures and tools.

Measures and tools to address category breaches

Where a CCP is to be reclassified as a result of the tiering assessment, and especially where a CCP is moved to a higher category and thus potentially poses more risks, measures might be proposed to ensure the CCP can return to the status of Tier 2 or Tier 1 within a reasonable amount of time, or, as a last resort, to allow time for an orderly transition to derecognition. The ESRB believes that a sound package of measures should target not only the CCPs but also clearing members and clients. In line with its previous response, the ESRB suggests that before any measure or tool is implemented, a thorough assessment of all costs, benefits and risks to financial stability should be made.

These measures could be aimed at either a voluntary or a mandatory reduction in the reliance of EU clearing members and EU clients on such TC CCPs and/or on clearing services in currencies that are classified as Tier 3, to the extent that such reliance creates financial stability risks for the EU. A voluntary reduction could take better account of the needs of clearing members and clients, and the ESRB would consider it a preferred outcome. However, the ESRB is aware that such a voluntary reduction has not occurred so far and that increasing the competitiveness of EU clearing (the "pull" effect) in isolation might not be sufficient to trigger a significant migration from TC CCPs to EU CCPs. At the same time, insufficiently investing in bolstering the supply side while targeting strong measures on the demand side, such as exposure reduction targets and/or capital charges, may result in clearing volumes migrating from the UK to other third-country jurisdictions, especially the United States.

In order to foster the migration of exposures from significantly systemic TC CCPs to EU CCPs, two types of complementary measures could be considered: (i) those aimed at providing an incentive to reduce exposures to Tier 3 CCPs and/or clearing services in currencies that are classified as substantially systemic; and (ii) those aimed at building commercially attractive EU alternatives, without which a reduction in exposures may not mean increased demand for the services of EU CCPs, but may instead increase clearing in other TC CCPs. Such increased exposure could result in the market fragmenting into two or three liquidity pools, one of which might not be subject to direct or indirect EU supervision. Three measures that could be deployed are described below.

Measure 1: capital charges on exposures if a CCP is moved to a different category

A reduction in exposures by means of regulation might be achieved via capital charges. Such a reduction could be implemented through three different tools at bank level: (i) changing the large exposures regime in CRR, (ii) using Pillar 2 to achieve exposure reduction or (iii) tweaking the treatment of NQCCPs.

The first of the three options involves adapting the large exposures regime in the CRR to clearing members' exposures to TC CCPs that belong in a given category, e.g. Tier 3. The calculation of large exposures excludes clearing members' trade exposures and default fund contributions to qualified CCPs (QCCPs) (Article 400(1)(j) of the CRR). However, Article 459 of the CRR might enable the European Commission to impose such requirements on relevant TC Tier 3 CCPs based on the assessment of the systemic relevance for the EU of certain clearing services. To be effective, these exposures would need to include client exposures. Therefore, together with amendments to EMIR, changes to the CRR and the Capital Requirements Directive (CRD IV)[16] might be needed to achieve the overarching objective of encouraging clearing at EU CCPs by increasing its attractiveness.

The second option, using Pillar 2 measures, has the advantage of being easier to implement than a Level 1 modification of the CRR/CRD. As part of the annual Supervisory Review and Evaluation Process (SREP), and in addition to the minimum capital requirements under Pillar 1, supervisors could apply bank-specific Pillar 2 requirements based on the (over)exposure a certain bank has to one or more substantially systemic TC CCPs. The capital charges on exposures to TC CCPs would be tailored to the specific risk profile of the institution in relation to its exposure to EU CCPs. These could be directly set at the level of the quantum of own funds requirements (as is generally done in the SREP procedure for calibrating the Pillar 2 Requirement (P2R) and the Pillar 2 Guidance (P2G)) or by giving a higher risk weight to excessive exposures. Prudential authorities already have the possibility of implementing such measures, but an explicit reference in EMIR would provide additional comfort. Finally, it should be noted that the Pillar 2 framework has equivalents in the legislative frameworks of other financial sectors (e.g. insurance) which would allow for equal treatment by broadening the scope of exposure reduction incentives for clients of this nature.

The third option, tweaking the NQCCP treatment, is more complex as it would require changes to the current structure set out in the CRR, which only distinguishes between QCCPs and NQCCPs. This current structure does not reflect the reality or the structure set out in EMIR, where QCCPs can be either Tier 1 or Tier 2 (or even Tier 2+/Tier 3) and have different characteristics that would justify different capital treatment. This misalignment between the CRR and EMIR complicates the application of capital charges. One solution could be to align the structures set out in the CRR and in EMIR to ensure that a certain categorisation under EMIR would automatically lead to a certain level of capital charge under the CRR.

To maximise the efficiency of exposure reduction measures and ensure a level playing field, all members and clients could be in scope of the adopted measures. Therefore, financial sectors other than banking should be considered, especially insurance companies, asset managers and investment funds. As explained above, some tools could be adapted (such as Pillar 2 in the case of insurance companies) to align incentives for these specific non-bank entities.

Measure 2: caps on exposure to certain TC Tier 3 CCPs

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[16] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

A voluntary reduction might, for example, be achieved by clearing members agreeing TC CCP exposure reduction targets with their supervisors. A regulatory option would be to activate concentration limits on EU counterparties' exposures to TC CCPs. Adherence to these targets would then be monitored. Efforts to build clearing capacity at EU CCPs would be hampered by "first-mover disadvantage", as those clearing members that were the first to clear at EU CCPs would be faced with lower liquidity than those that continued clearing at the current Tier 2/Tier 3 CCPs. Exposure reduction targets to which all EU clearing members would commit would address this first-mover disadvantage by spreading the costs of lower liquidity more evenly across clearing members. As the proposed changes could lead to increased costs for EU market participants, these potential costs, together with the unintended consequences of introducing such measures, should be carefully assessed.

Measure 3: mandatory active account

Another measure to reduce exposures to TC CCPs could be to make it mandatory for (private sector) EU counterparties to maintain an active account at an EU CCP. This option could also be combined with one or both of the first two measures to encourage the flow of clearing volumes through the EU CCP's account. This measure can only be applied to transactions where both counterparties are located in the EU, but the ESMA annual statistical report on derivatives clearing[17] shows that only 25% of all derivatives have intra-EEA counterparties, with the remaining 75% having a non-EEA counterparty. Nevertheless, if applied, a mandatory active account could mitigate the operational risk of a cliff-edge scenario in which EU entities are abruptly cut off from clearing services provided by TC CCPs. Over time, it could also lead to a reduction in excessive exposures to certain TC CCPs and increase the attractiveness of the EU CCPs, the latter being supported by a growing number of clients using their clearing services. This can only work if the EU CCP has, or is able and willing to develop, clearing services that are fungible or similar to the clearing services provided by the TC CCPs to which exposures need to be reduced. While this should not be an obstacle with respect to the clearing of classes of over-the-counter (OTC) derivatives subject to the clearing obligation, an adaptation period will be needed for EU CCPs to develop a satisfactory supply of such services for some other products. In addition, reducing excessive exposures to the TC CCP may mean that, over time, it is necessary to set a minimal quantitative level of activity in the active account. This target level could be expressed either in absolute or relative terms, for example by requiring clearing members to hold a given percentage of their total activity in the relevant products in their EU account. The level would have to be calibrated carefully to avoid excessive costs for EU entities, while still achieving a significant exposure-reducing effect. The cost-benefit analysis for the use of the measures and tools to address category breaches

[17] **ESMA Derivatives Markets: ESMA annual statistical report 2021**

would have to determine the adequate minimal level of activity and the possible cost-reducing measures (exemption of small participants, exemption of ongoing positions, gradual increase in the minimal level, etc.).

3. Other considerations for the forthcoming EMIR review

The ESRB has identified a few other proposals that might be relevant in this context. However, it notes that all proposals should be subject to a thorough cost-benefit analysis, with sufficient attention paid to risks and unintended consequences for the EU clearing market and EU clearing members.

Additional asset classes might be suitable for a clearing obligation. Possible ways to expand the scope of the clearing obligation could be to focus on asset classes such as commodities or foreign exchange derivatives.[18] Some of these products are traded both on-exchange and OTC. As the worrying example of nickel derivatives showed in March 2022, the opacity of the OTC market could distort the price-finding mechanism on regulated markets. Therefore, other products besides interest rate and credit derivatives should be analysed for a roll-out of the clearing obligation, with a view to increasing the scale of centrally cleared transactions and at the same time mitigating the risks by introducing central clearing for these products.

One way of increasing the use of EU CCPs for clearing would be to introduce an obligation to use an EU CCP if both counterparties were located in the EU and at least one EU CCP offered the necessary products. This would mean that TC (Tier 3) CCPs could only be used if one or both counterparties were not located in the EU and/or where there was no clearing obligation. This measure would increase the volumes cleared at EU CCPs but could be considered as a rather invasive measure that could disadvantage EU market participants and might be easy to evade through the use of non-EU dealers/intermediaries. There is also a risk that limiting market participants' choice of clearing location would disrupt the functioning of markets. Therefore, this option should be preceded by an impact analysis, leaving room for other market-based solutions.

The EMIR Regulation should be clear on the possibility of entering into interoperability arrangements for derivatives transactions. EMIR contains requirements for establishing and approving interoperability arrangements between CCPs in Articles 51 to 54, which are complemented by ESMA Guidelines[19] for the NCAs assessing these

[18] Any asset class will need to meet the conditions regarding standardisation and liquidity to be eligible for mandatory clearing. Physically settled commodities and foreign exchange derivatives are very complex in terms of risk management and not the most suitable asset classes in this respect.

[19] **ESMA Guidelines and Recommendations for establishing consistent, efficient and effective assessments of interoperability arrangements**.

interoperability arrangements. The legislative framework is silent on any distinction between interoperability for securities versus derivatives, but it is implicit that interoperability for derivatives transactions is not foreseen – although the framework does not explicitly exclude it either. More clarity on the specifics and the conditions under which interoperability for derivative transactions would be possible under the EMIR framework could help in addressing the fragmentation in the clearing landscape that might be the result of moving (part of the) clearing volumes from TC CCPs to EU CCPs. This could apply to interoperability between EU CCPs and between an EU and a TC CCP. In the past, the ESRB has been sceptical about establishing interoperability arrangements in derivatives clearing, but the concept could be reanalysed in view of the changed market circumstances in order to strike a balance between the potential benefits and the financial stability risks that could arise.

4. Conclusion

The ESRB welcomes the opportunity to use the upcoming targeted EMIR review to help increase the attractiveness of EU clearing and strengthen the supervision of (EU) CCPs. To this end, the ESRB has set out suggestions for fine-tuning the current CCP tiering framework and using other measures to draw more clearing business away from TC CCPs and towards EU CCPs, especially where such activities would endanger financial stability within the EU. Part of the measures proposed can be achieved through changes to the Tiering DA, which might make their implementation easier.

The ESRB is confident that these amendments would improve the current CCP landscape and make it easier to supervise it. At the same time the ESRB acknowledges that the proposed measures would need to be set out in greater detail, so that the potential benefits, risks and (unintended) consequences could also be properly assessed. It stands ready to do so if the European Commission wishes.

Classification of TC CCPs

Tiering category	Description	Current list of TC CCPs	Potential list of TC CCPs – after new criteria are applied
Tier 0 ***(new and implicit)***	CCPs that are NOT recognised by ESMA, either because they are not compliant or because they are in non-equivalent jurisdictions, or a combination of the two	Potentially all TC CCPs worldwide. Note that a number of TC CCPs are currently suspended and can still access the EU market despite not being recognised[20].	
Tier 1	CCPs that are recognised by ESMA but where volumes at the EU, Member State or currency level are not of systemic relevance	ASX Clear (Futures) Pty Limited ASX Clear Pty Limited Hong Kong Securities Clearing Company Limited HKFE Clearing Corporation Limited OTC Clearing Hong Kong Limited The SEHK Options Clearing House Limited Japan Securities Clearing Corporation Tokyo Financial Exchange Central Depository (Pte) Limited Singapore Exchange Derivatives Clearing ICE Clear Singapore JSE Clear ICE NGX Canada Inc. Canadian Derivatives Clearing Corporation	[some CCPs could move from T1 to T2]

[20] It includes CCPs from the following jurisdictions: Argentina, Chile, China, Colombia, Indonesia, Israel, Malaysia, Russia, Taiwan, Thailand, and Turkey.

		Asigna Compensacion y Liquidacion SIX x-clear AG Korea Exchange, Inc. Chicago Mercantile Exchange, Inc. ICE Clear Credit LLC Minneapolis Grain Exchange, Inc. ICE Clear US, Inc. National Securities Clearing Corporation Dubai Commodities Clearing Corporation Nasdaq Dubai Ltd B3 Nodal Clear, LLC New Zealand Clearing Limited Multi Commodity Exchange Clearing Corporation Limited LME Clear Limited The Clearing Corporation of India Ltd Indian Clearing Corporation Limited NSE Clearing Limited India International Clearing Corporation (IFSC) Limited NSE IFSC Clearing Corporation Limited	
Tier 2	CCPs that are recognised by ESMA but where volumes at the EU, Member State or currency level are of systemic importance	LCH Limited ICE Clear Europe Limited	LCH Limited ICE Clear Europe Limited [some CCPs could move from T1 to T2]

Tier 3	CCPs and/or clearing services that are of such substantial systemicness that they are not allowed to provide their clearing services from outside the EU	LCH Limited ICE Clear Europe Limited	LCH Ltd ICE Clear Europe Limited [some CCPs could move from T2 to T3]