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WORKING DOCUMENT

From:	French delegation
To:	Working Party on Financial Services and the Banking Union (EMIR/CCP) Financial Services Attachés
Subject:	Requirement of an operational active account (OAA) in EMIR3

FR Non-paper – Requirement of an operational active account (OAA) in EMIR3

1. **In December 2021, ESMA identified clearing segments of UK CCPs as being of « *substantial systemic importance* » to the EU,** meaning that given the EU's exposure to those segments, risks to the EU financial stability could arise in certain scenarios. These segments are SwapClear of LCH Ltd for the clearing of IRD denominated in euro and Polish zloty, as well as the Credit Default Swaps (CDS) service and the Short-Term Interest Rate Derivatives (STIR) service of ICE Clear Europe Ltd, in both cases for euro-denominated products[1].
2. **The objective of the EMIR3 proposal should be to address the potential risks that the two Tier2 CCPs may pose for the EU financial stability, in certain circumstances,** while avoiding disproportionate costs for EU players and negative impact on their competitiveness.
3. **The effective requirement for EU players to have an operational active account (the operational account requirement, OAR) defined as a "permanently functional account" would allow to meet those objectives in a balanced manner,** for three reasons:
   - **(i)** it would enhance EU players' operational resilience: with this OAR, **every EU actor under the clearing obligation will maintain an account at an EU CCP**. **For EU players not using this account as their main one, it would still play the role of an EU ready-to-use plan B to fall back on** should a major shock hit the global financial markets or in a scenario of regulatory or supervisory divergence. Indeed, all operational channels, contracts etc. would already be in place should EU actors need to swiftly boost their clearing position in the EU with new trades.
   - **(ii)** it will gradually reduce the EU reliance over Tier2 CCPs: the OAR has the very notable advantage of letting EU players choose the trades to be cleared within the EU, according to their specific needs and business models and hence without endangering their own market positions. Indeed, smaller EU players with no specific preferences in terms of clearing location are likely to prefer to maintain only one account and so exclusively use the mandatory OA at the EU CCP, for all their trades. We expect that it will be the case for a share of EU players clearing exclusively in EUR. In terms of number of EU players in scope, the data provided by two large EU clearing members show that respectively 39% and 72% of their EU clients today clear exclusively their IRS in a UK CCP. Among these clients, which will all be subject to the mandatory account requirement described earlier, around respectively 56% and 40% clears in EUR only, meaning that they will have no need of using the cross-currency services provided overseas. They are consequently very likely to only use the EU CCPs for their trades in order to recover the cost of fulfilling the account requirement at the EU CCPs. This in itself will enhance the attractiveness of EU CCPs as more business will lead to more liquidity, better pricing, etc.
   - **(iii)** it maintains incentives for EU CCPs to be attractive: the EU CCPs, in order to attract more transactions than those required by the OAR, will still have to provide competitive conditions. As such, this OAR reduces the risk of dominant position abuse. For EU players, to have multiple accounts enables them to diversify risk and to be able to enjoy the best market conditions. For the EU CCP market as a whole, this would lead to autonomous growth and thus reduced dependency on Tier2 CCP's.
4. **To ensure the effectiveness of the OAR, its permanent functional nature could be further framed by ESMA and the reality of its use be supervised by national competent authorities.** When setting these criteria, ESMA should solely aim at ensuring that the accounts are functional so that they are operationally compatible with a quick boost. These criteria should ensure that this EU account is operationally 'live'. These criteria could include demonstrating that legal documentation, IT connectivity and internal processes are in place. ESMA could regularly stress test the possibility of European market participants to switch all new trades to an EU CCP, if necessary.

[1] The future closing of the CDS segment of ICE Clear Europe due in 2023 will conduct to exit this segment from the list of activities of substantial systemic importance. We will hence focus only on IRD.

5. **The OAR would be a move from the *status quo,* for three reasons.** First, those accounts would be mandatory for 100% of EU players subject to the clearing obligation - including EU players whose clearing by an EU CCP is intermediated by non-EU clearing members. As of today, around 40% of European clients of European clearing members do not have an account at an EU CCP for IRS[2]. The figure is unknown as regards EU clients intermediated by non-EU clearing members but we can expect that a non-negligible share of them do not have an account at an EU CCP for IRS either. Second, those mandatory EU accounts will increase the operational readiness of all EU market parties to act in a crisis: precise criteria to assess their operationality should be designed and their fulfillment supervised. And third, in conjunction with other measures from the EMIR3-proposal, it will most likely increase the volume of clearing within the EU and consequently gradually reduce reliance on Tier2 CCP's, by making EU CCPs the default option for EU market participants.
6. **To fulfill the objective of safeguarding the EU financial stability described in 2., the operational active account requirement could usefully be completed with further work to improve ESMA's supervision over Tier2 CCPs**, notably through including recovery and resolution aspects[3], and ensuring the current comparable compliance framework does not deprive ESMA from its supervision capacity. ESMA should also monitor UK legislative and supervisory divergence from the EU, and can propose policy options if the UK decides to diverge significantly from the EU resulting in increased systemic risk, for instance that EU players clear a proportion of new trades at their EU operational active account.

ANNEX – Drafting suggestion (the initial version is the COM one, the changes in black are from the PRSE option 3 suggestion, and the red ones are NLD and FRA suggestions).

Article 7a

*1. Financial counterparties ~~or~~ **and** ~~a~~ non-financial counterparties that are subject to the clearing obligation in accordance with Articles 4a and 10 and clear any of the categories of the derivative contracts referred to in ~~**paragraph 2**~~ the Delegated Act referred to in Article 25(2c) shall have, for such contracts, at least one permanently operational account ~~clear at least a proportion of such contracts at accounts~~ at a CCP~~s~~ authorised under Article 14, **where ~~such CCPs provide~~ clearing services for the derivatives concerned are provided by CCPs authorised under Article 14, by 6 months after the Commission adopts a Delegated Act according to Article 25(2c).***

~~***2. The categories of derivative contracts subject to the obligation referred to in paragraph 1 shall be any of the following:***~~

~~***(a) OTC interest rate derivatives denominated in euro and Polish zloty;***~~

~~***(b) Credit Default Swaps (CDS) denominated in euro;***~~

~~***(c) Short-Term Interest Rate Derivatives (STIR) denominated in euro.***~~

[2] See the Commission's impact assessment

[3] In its December 2021 report, ESMA made several recommendation which should be further assessed and discussed within the Council : i) introduction of appropriate tools to address the cross-border systemic risks during a crisis, including in a recovery and resolution situation ; (ii) examination of the extent to which Tier 2 CCPs can be required to comply directly with all or part of the provisions embedded in the CCPRR ; (iii) approval power for ESMA in respect of the recovery plans for Tier2 CCPs ; (iv) ESMA's consultation before the validation of the resolution plan of a Tier2 CCP and in case of resolution, before any discretionary measures are taken that could potentially have adverse impacts on an EU market participant and potentially on EU financial stability ; (v) ESMA's power to request its consultation by Tier2 CCP and its resolution authorities priori to imposing restriction, suspension or termination of access to EU clearing members.

~~***3. A financial counterparty or a non-financial counterparty that is subject to the obligation set out in paragraph 1 shall calculate its activities in the categories of derivative contracts referred to paragraph 2 at CCPs authorised under Article 14.***~~

2. Within [PO : please insert the date xx months after the date of entry into force of this regulation] ESMA shall, in cooperation with the EBA, EIOPA and ESRB, and after consulting the ESCB, develop draft regulatory technical standards specifying the criteria of "permanent operationality" to be fulfilled in order for the account requirement referred to in paragraph 1 to be deemed fulfilled , where appropriate differentiating between different sub-categories of the derivatives contracts concerned.

~~***4 2. 3.***~~ *A financial counterparty or a non-financial counterparty that is subject to the obligation set out in paragraph 1 shall report to* ***its competent relevant authority*** ~~***the competent authority of the CCP or CCPs it uses the outcome of the calculation referred to in paragraph 2 on an annual basis, confirming their***~~ ***its*** *compliance with the obligation set out in* ~~***that***~~ *paragraph* ***1****.* ***The*** ~~***CCP's***~~ ***relevant*** *competent authority shall immediately transmit that information to ESMA* ~~*and the Joint Monitoring Mechanism referred to in Article 23c*~~*.*

~~***6. Where ESMA undertakes an assessment pursuant to Article 25(2c) and concludes that certain services or activities provided by Tier 2 CCPs are of substantial systemic importance for the Union or one or more of its Member States or that services or activities that were previously identified by ESMA as being of substantial systemic importance for the Union or one or more of its Member States no longer are, the Commission is empowered to adopt a delegated act to amend paragraph 2 accordingly, in accordance with Article 82.***~~

7. Within [PO: please insert the date 12 months after the date of entry into force of this Regulation], ESMA shall update its assessment of the substantial systemic importance of third-country CCPs or their clearing services as referred to under Article 25(2c) of this Regulation.