Deutsches Aktieninstitut

The review of the central clearing framework in the EU

Active account can help market driven migration!

Response of Deutsches Aktieninstitut e.V. to targeted consultation on the review of the central clearing framework in the EU, 22th March 2022

Introduction

Deutsches Aktieninstitut, the German association of capital markets-oriented companies, appreciates the opportunity to comment on the targeted EU consultation on the review of the central clearing framework in the EU.

Deutsches Aktieninstitut and its members are strongly committed to fostering capital markets across the EU as only deeper integrated markets will provide the necessary prerequisites for capital markets participants to fully benefit from its advantages. More integration can however not only be achieved by removing cross-border obstacles within the EU. In addition, it is essential that sound market ecosystems are being created, catering to the whole range of market participants. In this context, market infrastructure plays a crucial role, as it provides important platforms for market activity.

We observe that post-Brexit, improvement of market infrastructure in the EU has been achieved, effectively enabling various market infrastructure providers to compete with third country competitors. This holds ie true in the context of clearing of OTC Interest Rate Derivatives, where Eurex Clearing offers EU market participants to clear these transactions at virtually the same terms offered by the incumbent CCP in the UK.

Nevertheless, the decision of the EU Commission from 8 February 2022, to renew the current time-limited recognition for Tier 2 third country CCPs until mid-2025 highlights that there still exists significant reliance on those CCPs, in particular as regards to the clearing of derivatives transactions denominated in Euro or other EU Member-State currencies. This cannot be in the interest of the EU, which is why the forthcoming three years need to be used to incentivize more clearing activity within the EU. Otherwise, the dependence will only be perpetuated, thereby creating an ever-increasing financial-stability risk for the EU.

Deutsches Aktieninstitut suggests:

1. Incentives and measures to transfer clearing from third country CCPs to EU CCPs

   To transfer more clearing from third country CCPs (especially UK CCPs) to EU CCPs, we believe that market driven incentives should be pursued rather than imposing punitive measures:

   As mentioned before, substantial clearing capacity at competitive conditions has been built up within the EU. It is now more than time to make use of it by market participants. This is why we suggest to require EU based market participants falling under the clearing obligation to set up an active account with an EU CCP. This would support a market driven migration and ensure that EU market participants are prepared for the end of the temporary equivalence of Tier 2 third country CCPs. The execution of the migration should be monitored by national supervisory authorities. Last,an active account requirement would help to reduce any systemic risk potentially resulting from a cliff-edge scenario in which large positions would need to be migrated in a short time period.

Furthermore, we propose to broaden the scope of clearing participants to public entities which exceed certain exposure levels. To oblige public entities to clear would send an important message of trust to the market.

2. Caution: Retain hedging exemption for non-financial companies / Refrain to lower clearing thresholds

Whilst we deem the increase of clearing activity within the EU an important cornerstone to foster the Capital Market Union project, we warn that increasing clearing activity should not be an end in itself.

The clearing obligation under EU law is the result of a thoroughly calibrated decision to address systemic risk of financial derivatives markets. Where such a risk is not present, there is no justification to oblige counterparties to clear.

Non-financial counterparties (NFCs) are generally recognised as not contributing to systemic risk, considering both their low market shares of financial derivatives (i.e. the actual “size” of their potential contribution to counterparty risk) and their low levels of interconnectedness (i.e. their limited contribution to potential contagion effects). This assessment should be pertained. Lowering the clearing threshold for non-financial companies to increase clearing activity should thus not be envisaged. We rather see the need for improvements in terms of higher thresholds especially for commodity derivatives in the EMIR framework: Financial innovation particularly regarding sustainability linked instruments like virtual power purchase agreements or sustainability linked derivatives may lead to uncertainties for non-financial companies whether a derivative could be classified as hedging. Although the legislator is asked to declare these instruments as hedging, other instruments may enter the market in future and require further clarification. In order to avoid that non-financial companies face the risk to cross the clearing thresholds or to restrict the use of these instruments resulting in inefficiencies, the legislator should provide more leeway to handle forthcoming instruments and associated legal uncertainties by increasing the thresholds. Furthermore, the EU EMIR framework provides EU energy firms with limited headroom to offer suitable OTC hedging transactions to renewable energy producers and its clients in the EU and elsewhere in the world. As banks more and more leaving these markets there is only little chance that the financial sector compensates the supply of commodity derivatives. Direct adverse effects on the liquidity of OTC derivatives markets, the energy transition and European competitiveness will be the consequence. In addition, an increase of the clearing thresholds would lead to a better level playing field with other jurisdictions like Australia, Singapore or the US. Compared to these countries the EU EMIR regime includes the lowest clearing threshold applicable to the largest set of entities, products and activities.

Last, we are of the opinion that the exemption of non-systemic relevant NFCs from the obligation of clearing/bilateral Margining should be preserved**.**

Derivatives under the so called “hedging exemption” are not counted against the clearing thresholds as they are concluded for risk mitigating purposes only. NFCs using financial derivatives for hedging purposes are not creating systemic risks because the underlying hedged item is per se implicit collateral of hedging financial derivatives, gain/loss being compensated by the offsetting loss/gain related to the underlying asset.

The obligation to clearing/bilateral margining derivatives used by NFCs for hedging purposes would therefore impose disproportionate costs in terms of cash funding and processes on NFCs that are not contributing to systemic risk.

Contact

Dr. Norbert Kuhn
Deputy Head of Capital Markets Department
Head of Corporate Finance
Phone +49 69 92915-20
kuhn@dai.de

Maximilian Lück
Head of EU Liaison Office
Phone +32 2 7894101
lueck@dai.de

Frankfurt Office:
Deutsches Aktieninstitut e.V.
Senckenberganlage 28
60325 Frankfurt am Main

EU Liaison Office:
Deutsches Aktieninstitut e.V.
Rue Marie de Bourgogne 58
1000 Brussels

Berlin Office:
Deutsches Aktieninstitut e.V.
Alte Potsdamer Straße 5, Haus Huth
10785 Berlin

Lobbying Register German Bundestag: R000613
Transparency Register: 38064081304-25
www.dai.de

We want capital markets to be strong, so that they empower companies to finance great ideas and to contribute to a better future for our communities.

We act as the voice of capital markets and represent the interests of our members at national and European level.

We promote connections between our members, bringing them closer together and providing them with the most compelling opportunities for exchange.

As a think tank, we deliver facts for the leaders of today and develop ideas for a successful capital markets policy. We do this because companies, investors and society alike benefit from strong capital markets