

## Technical paper on Active Accounts

### Executive Summary

In the paper “Targeted consultation on the review of the central clearing framework in the EU” of February 2022<sup>1</sup>, one of the measures proposed for consideration by the European Commission was the requirement for an “active account”, i.e. the requirement to “maintain[...] an active account with an EU CCP for the products that are available inside and outside the EU.” We understand that such a measure would require all, or a subset of, EU clearing participants to have an account at an EU CCP or a tier-1 CCP in addition to, or as an alternative to, an account at a tier-2 third country CCP.

We accept that having viable options is always good risk management<sup>2</sup>, but note however that this is a tool that could, depending on how it is designed, add costs and risks for EU clearing participants (be they clearing members or clients).

As we understand that this proposal is under serious consideration by the Commission, we provide analysis as to the potential consequences of different design choices.

We look at three policy options:

- Policy Option 1: No active accounts
- Policy Option 2: Active accounts without a target minimum level of activity
- Policy Option 3: Active accounts with qualitative and quantitative usage requirements – minimum activity levels

For each policy option we analyse the impact on market participants and how the policy option could be operationalised and supervised.

We also would like to refer to our paper “A Roadmap to Make European Clearing More Attractive”<sup>3</sup> for proposals on how to make clearing in the EU more attractive without disadvantaging EU firms.

---

<sup>1</sup>

[https://ec.europa.eu/info/sites/default/files/business\\_economy\\_euro/banking\\_and\\_finance/documents/2022-central-clearing-review-consultation-document\\_en.pdf](https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/2022-central-clearing-review-consultation-document_en.pdf)

<sup>2</sup> Including for mitigating regulatory risk.

<sup>3</sup> <https://www.isda.org/2022/10/19/a-roadmap-to-make-european-clearing-more-attractive/>

### **Policy Option 1: No active accounts**

This option represents the general preferred outcome for ISDA members, as this option would avoid any risk of disadvantaging EU clearing participants.

For this policy option, we do not provide analysis on operationalisation and supervision as it is the status quo.

We also point out here that already a sizeable part of the business in euro-denominated OTC derivatives has moved to the EU.<sup>4</sup>

### **Policy Option 2: Active accounts without a minimum level of activity**

#### Considerations for this policy option

##### *Minimum requirement: active accounts need to be operational (qualitative target)*

If the Commission was to decide to mandate active accounts, a requirement that active accounts need to be operational would make sense. This would mean that clearing participants would have to demonstrate that these accounts are live and can be used for clearing, including by having set up not only legal documentation and IT connectivity, but also internal processes. Clearing through these accounts should have been tested with several live transactions, and a sufficient quantum of open risk should be maintained to ensure margin processes remain current and operational on a daily basis.

##### *Third country CCP scope*

Given the aim of the Commission is to mitigate potential risks to EU financial stability, it follows that this requirement should only apply, as a maximum, to services identified by ESMA as super-systemic (SwapClear interest rate swaps in EUR and PLN, ICE EU CDS – although this service is scheduled to close in Q1 2023 – and short-term interest rate futures denominated in EUR). Also, this requirement can only apply to a tier-2 third country CCP that has comparable clearing services in the EU: for example, it would not be possible to require alternative accounts for products cleared, for instance, at the London Metal Exchange, even if it were subsequently classified as a tier-2 CCP (it is currently a tier-1 CCP), as there are no comparable clearing services in the EU. Similarly, not all products cleared at current tier-2 CCPs (SwapClear and ICE EU) will be offered by EU CCPs. It is therefore difficult to envisage how active accounts could be mandated for anything other than for the euro and other Union currencies.

We also note that the alternative CCP in the EU (or tier-1 CCP) does not necessarily have to be the same for all currencies and products and, potentially, a participant may require

---

<sup>4</sup> See our paper “A Roadmap to Boost the Attractiveness of European Clearing”

several additional active accounts at several CCPs. Also, liquidity pools in some Union currencies are very small and splitting these will be even more detrimental to their liquidity.

### Product and participant scope

We also note that to avoid disincentivising central clearing, active account requirements should only apply to clearing participants and products subject to the clearing obligation and not to clearing participants clearing voluntarily, as these clearing participants could avoid the requirement by no longer clearing voluntarily.

### Impact on clearing participants

#### *Proportionality*

When considering which entities would be subject to the requirement to have active accounts, proportionality should be considered.

Many clearing participants including, we believe, the largest ones already have accounts at EU CCPs and/or third country tier-1 CCPs. This is because having fallbacks is good risk management and, in case of many large clearing members, they offer client clearing services at many CCPs.

For clearing members, the fixed cost of accessing a CCP (excluding fees and collateral costs) are comparable in size, and include legal work, fixed CCP fees and IT effort. Larger clearing participants, however, have more business volume across which to amortise this fixed cost than smaller clearing members. Therefore, the requirement for active accounts will impact smaller clearing members more than larger participants.

For non-members, the cost of accessing a new CCP as a client is lower than accessing a CCP as a direct member, albeit not cost-free. Many clients already have accounts at multiple CCPs, including EU CCPs and tier-2 third country CCPs.

Any proportionality issue could therefore be at least partially mitigated by allowing clearing participants to comply with the requirement for active accounts by setting up a client clearing relationship for the required accounts, even if they are direct members at other CCPs, including tier-2 CCPs. This could potentially be more cost effective especially for clearing participants that already use a client clearing service provider for accessing other CCPs. On the other hand, clients could lose efficiency by splitting their flow over several CCPs (for instance due to the impact of pricing structures, like volume discounts), which would make an active account more costly.

Another policy option would be to exempt smaller clearing participants (regardless of whether they clear as a member or as a client) from the requirement to have an active account. This would however pose the same problem as with any other threshold:

- If the threshold is too high, the measure would be focused on clearing participants that already have such accounts.

- If the threshold is too low, there will be a set of clearing participants that are just above the threshold and will be required to set up such accounts, at a higher relative cost than larger clearing participants that already have these accounts. It will be extremely difficult to calibrate such a threshold in a fair way. Having a threshold could also lead clearing participants that are close to this threshold not to hedge risk, to avoid having to open a second clearing account.

It is, of course, possible that smaller clearing participants may react by retaining just a single account at an EU CCP rather than a non-EU CCP, therefore foregoing the benefit of the largest global liquidity pools.

#### *Access to a CCP as a clearing member*

If clearing participants do not have the required accounts already, they will have to do the following if they want to access the EU CCP as clearing member:

- Apply for an account.
- Negotiate legal documentation with the CCP.
- Establish IT connectivity.
- Adapt middleware, e.g. to be able to select CCPs.
- Clear a ceremonial transaction to prove that the connections work.
- Set up required accounts (external accounts at custodians, tri-partite providers, PPS/APS banks, and internal accounts).
- Ensure liquidity sourcing / risk limits / capital are in place.
- Assess potential impacts on staffing.
- Adapt/change/test working practices, procedures and policies to include the new CCP(s).
- Implement a management process for the business for which the new CCP(s) are used.
- Provide staff training and certification where applicable.
- Pay a default fund contribution and be ready to pay assessments.
- If the firm plans to offer client clearing there would be additional work, for example it would need to ensure FRANDT compliance, which poses additional requirements if OTC derivatives under the clearing obligation are involved.
- Pass CCP due diligence which can be demanding.
- Ensure that it fulfils CCP requirements for clearing members, which may include specially certified staff, regularly taking part in default exercises.

#### *Access to a CCP as a client*

If a firm wants to discharge the requirement for an active account as a client, the process is less complicated:

- Set up connectivity if not yet in place.

- Ask their clearing members to clear at a new CCP.
- Update documentation if required. This should be straightforward if the client already has a clearing agreement.
- Should the client require segregation at the new CCP, there is additional documentation and opening of accounts involved.
- Adapt middleware, e.g. to be able to select CCPs.
- Clear a ceremonial transaction to prove that the connections work.
- Ensure liquidity sourcing / risk limits / capital are in place.
- Assess potential impacts on staffing (unlikely as a client).
- Adapt/change/test working practices, procedures and policies including the new accounts at EU CCPs.
- Implement a management process for what business the new CCPs are used.
- Provide staff training and certification where applicable.
- Consider the potential impact on clearing fees.
- Set up segregated accounts if required. EU CCPs need to be able to support the volume of new account setup requests.

### Supervision

Supervision of active accounts without prescribed minimum activity levels is a subset of supervision of active accounts with prescribed minimum activity levels. To avoid duplication, please refer to the analysis of policy option 3 for the analysis of supervision.

### **Policy Option 3: Active accounts with minimum activity levels**

#### Impact on clearing participants

We believe that prescribing minimum levels of activity would be both complex and counterproductive for a number of reasons for EU clearing participants in general – see next chapter - but also for EU market makers or EU banks offering client clearing services.

For EU market makers for example, target levels of activity – without providing for adequate exemptions would have a material impact on their ability to compete with non-EU peers. EU market makers would have to restrict business with non-EU clients.

This is because:

1. Market makers have to clear at the CCP that their counterparty requests if the counterparty is a client, therefore have no influence over clearing location for a significant part of market making trades.
2. EU market makers need to be able to re-hedge themselves in the global market, often with non-EU participants, to have a chance to provide competitive quotes to their clients. Including market making business in activity levels would make the

market making businesses of EU banks uncompetitive and would potentially restrict competitive prices for end-users.

Furthermore, if the market making business was subject to minimum activity levels, these firms might be restricted on the extent to which they could participate in the default management process at tier-2 CCPs, and if they can participate, on how they can manage won auction portfolios going forward.

Non-EU market makers would not be subject to the same restrictions. It is unlikely that major non-EU clients would accept such restrictions.

The same is true for the client clearing businesses of EU banks, who could also be forced to restrict the business of non-EU clients to meet any such targets, with the likely outcome that these clients will simply move their business to a non-EU broker that does not restrict them.

The impact of target levels of activity would be such that EU clearing participants may struggle to deal, or be led to deal to a lesser extent, with non-EU counterparties. This could be damaging, as for instance, we believe non-EU funds and other non-bank financial institutions provide substantial volumes, often in the opposite direction to transactions from EU asset managers and EU domiciled banks. The global nature of the market in EUR products should not be overlooked.

Restrictions by prescribed levels of activity might also generally mean that EU clearing participants cannot always execute transactions at best prices, but would have to execute certain transactions in a smaller liquidity pool to hit the usage target.

#### *Participant and account scope of prescribed minimum activity levels*

Prescribed activity levels should only ever be applied to accounts and activities where the choice of CCP is in the hands of the firm subject to the threshold. Therefore, the target cannot be applied at the aggregate clearing member level, as the clearing member has no influence over where its clients want to clear.

- With this in mind, where target levels of activity are considered, both market making as well as client clearing must fall out of scope as it is the client, and not the dealer, that determines the CCP for each transaction.
- Target levels of activity, if they are applied, should only be applicable to the propriety trading and own-account/asset-liability hedging activities of EU clearing participants.

For market participants that offer market making as well as trading for their own account, we see two options as to how the types of business could be delineated:

1. Use the market maker definition in MiFID II: *“A market maker is a person who holds himself out on the financial markets on a continuous basis as being willing to deal on*

*own account by buying and selling financial instruments against his proprietary capital at prices defined by him” (Article 4 (1) (7) MiFID II).*

2. Another way to determine the scope of activities would be to align with the definition of Internal Risk Transfer as set out in the Fundamental Review of the Trading Book (FRTB). Trades subject to this definition (typically those between a Treasury function managing the asset/liability management (ALM)/Funding activities of a firm in a Banking Book) would be considered the “Own Account” business of a firm, and activities outside this framework considered “Market Making”. The notable feature of Internal Risk Transfer activities is that they must be hedged directly with external market participants, rather than with internal market making desks, thus making this scope of business easy to identify.

In addition to the fact that the clearing member cannot influence where a client chooses to clear, the clearing member will not know how much activity a client has at a specific CCP. This is because a client could have several clearing members through which it conducts business at several CCPs. End-user clients can also utilise different asset managers. Therefore, client activity levels can only be supervised at client LEI level, which would encompass all positions of a client. Whether each client is compliant with any usage targets should therefore be overseen by the clients’ supervisors. In the same vein, for clients, the supervision of usage targets should be at the level of end-clients, not the manager of client accounts.

Similar to clients splitting activity across asset managers, banks might split activity between different legal entities. In many large banks, the clearing member which would hold the active account could be another entity than the market making business, though in many cases it is not. We therefore propose that banks can pool their EU business and that activity levels should be reviewed at the level of the overall EU entity.

#### Operationalisation of prescribed minimum levels of activity

EU clearing participants would have to establish reporting and management frameworks to manage and report compliance with minimum level of activity targets, which themselves would need to be clearly and robustly defined. This would create costs and complexity for EU participants and would create an unlevel playing field with non-EU competitors, which would not be subject to similar requirements.

If these target levels of activity are low, the cost of setting up a framework for managing towards the target would be disproportionate compared to the impact of the target. If the target levels are high, as previously stated, EU clearing participants would be disadvantaged compared to their global peers as they would face a restricted choice of where to clear.

Clearing participants will also have to set up processes to make sure that they comply with activity level targets in real time. This will probably require some feedback loop of current activity level targets to traders. Larger clearing participants will likely try to integrate the

usage into trading systems, so traders know whether they are on track to be compliant with targets. All the rules as to which accounts, businesses or books are in scope will have to be part of this feedback loop too.

Such effort is likely only feasible for larger clearing participants. Smaller clearing participants will potentially struggle to automate the calculation of actual usage of active accounts and will have to rely on manual solutions.

#### *How can these targets levels be calculated (measurement)*

There are several possible metrics (notional values, dv01, IM etc.) to measure levels of activity, all of which present challenges:

*Notional values:* Activity levels based on notional values are easy to calculate and would be in line with other regulations, like the clearing thresholds. However, outstanding notional values are easily manipulated by selective compression, or could be affected by less efficient compression in one CCPs versus more efficient compression in another CCP. Furthermore, activity levels based on notional amounts would tend to incentivise the clearing of shorter duration trades, which tend to have larger notional amounts, at the EU CCPs.

*Frequency/trade count/trade registration:* Any measure driven by trade count would be easy to be calculated but could be affected by compression in a similar way as nominal values.

Using frequency would also disadvantage businesses that have a high trade count with low risk, like market making business.

*IM:* Initial margin would introduce a level of risk sensitivity, but would be difficult to calculate, as not all portfolios at a given CCP might count towards the activity levels. Using IM would include a lot of factors and therefore be a good proxy for risk, but would have to be supported by involved CCPs, for instance by calculating and reporting the standalone IM for positions in scope to each clearing participant. Also, IM models are different between CCPs. The activity level based on IM might fluctuate because these CCPs utilise different anti-procyclicality tools.

*A standardised risk level (dv01, SA-CCR):* A risk measure like dv01, or if the Commission requires something more standardised, the Standardised Approach for Counterparty Credit Risk (SA-CCR) could provide a risk sensitive calculation of activity level that would not be affected by compression or different APC tools and the ratio would be stable enough without being affected by transactions that do not carry any risk. Also, if the aim of requiring active accounts is to reduce systemic risk, such a risk-based measure might be preferable. In addition, dv01 has the benefit of being the metric by which firms tend to manage their own risk, and is also a metric that is familiar to traders. It is much simpler to calculate than IM, and the number of variables is much lower, leading to much more consistent figures across firms and across CCPs. Dv01 however is more complex to calculate than a measure like notional.



### Supervision of active accounts with prescribed minimum activity levels

As mentioned above, compliance with minimum activity levels can only be supervised at the clearing participant level. It cannot be supervised at the clearing member level for its clients as a clearing member will not see the full picture if clients use several clearing members. A clearing member could see a client as not having an active account at all, or with no sufficient activity if this client has another account at an EU CCP or tier-1 CCP with another clearing member.

Supervision of large clearing members' minimum activity levels will be straightforward, both because large clearing members will likely have implemented the calculation of the usage of active accounts in their systems and because NCAs will have a close relationship with these clearing members.

It will however be very challenging for supervisors of clients to keep track of their usage of active accounts because of the:

- sheer number of end-clients.
- likely less close relationships between NCA and end-clients.
- calculation of the activity levels, which might be less automated for end-clients (unless this is done by their manager, but this would require the client having all accounts at one manager).

For Financial Counterparties, supervision of clients' active accounts might be done via the client's asset or pension manager, but we believe that investment firms are supervised differently and to a differing extent depending on their size.

A potential solution could be a review of targets via data from EMIR trade reporting.

It is completely unclear how the compliance of Non-Financial Counterparties with active accounts or minimum activity levels could be supervised.

## **About ISDA**

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 78 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: [www.isda.org](http://www.isda.org). Follow us on [Twitter](#), [LinkedIn](#), [Facebook](#) and [YouTube](#).