ISDA Safe, Efficient Markets

ISDA response to ESMA's consultation paper on guarantees as CCP collateral and on certain aspects of CCP investment policy[1]

Executive Summary

Eligibility conditions for guarantees

While we broadly agree with the conditions proposed by ESMA, we do have specific comments on some of the proposed conditions, which would unnecessarily restrict the extent to which non-financial counterparties may use this type of collateral, while at the same time insufficiently addressing the broader risk implications for the clearing ecosystem, including on CCP resilience and clearing members who choose to accept this type of collateral from their clients. Subject to the requirements applicable to this type of collateral, we would note that whether to accept this type of collateral from clients remains in the first instance a commercial and risk decision for the clearing member to make, within its own risk appetite and limit framework. It is critical that the use of this type of collateral is appropriately calibrated, within strict concentration safeguards and robust eligibility conditions, so that it does not introduce any contagion risk in the system. When done safely, we do recognize that guarantees afford non-financial counterparties with useful alternative means of meeting collateral requirements, potentially averting dash-for-cash dynamics in times of stress and avoiding the need for ad-hoc emergency measures to ease strains arising from collateral demands.

On the conditions set out in the draft RTS, the proposal that a CCP can only call a guarantee where a clearing member defaults would not appropriately protect the CCP nor the clearing member against a default of its client. Where a client accesses the CCP through a clearing member, we propose to make it a requirement for guarantees to include two beneficiaries. Guarantees should be irrevocable and unconditional, which effectively means that they should be payable on demand, and the payment should occur within a short timeframe. We do not think that the use of guarantees should be contingent on a default event, as this would make such instruments insufficiently responsive if the beneficiary is required to demonstrate that a default event has occurred. In the CCP context, the default could also be either the default of the client or the default of the clearing member. Rather, the guarantee should be payable on demand, with the requirement that the issuing bank delivers the funds to either the CCP or clearing member, as applicable, within a short timeframe, defined by the CCP and clearing member in the agreement with the issuing bank.

We also suggest to further specify in the RTS the ways in which these instruments should be embedded in the risk management framework of the CCP, by requiring CCPs to: a) consult the risk committee in the design of the limit system applying to guarantees, b) take into consideration the impact of a default of an issuing bank in their stress testing, and c) test the capacity to draw on a guarantee, or to transfer it to a clearing member, on a yearly basis.

[1] ESMA Consultation Paper on Guarantees as CCP Collateral and CCP Investment Policy

Provided that all the eligibility criteria are met, and within the CCP's concentration limit framework, CCPs and clearing members should remain free to decide whether to accept these instruments, and if so, from which non-financial clients, and from which issuers.

The guarantee should also operate as a reduction of credit exposure for the clearing member, essentially because payment to the CCP is irrevocably agreed up to a specified amount by the issuing bank. If the clearing member passes this through to the CCP as collateral, the clearing member's exposure to the CCP should reduce correspondingly.

We also provide suggestions to consider how uncollateralized guarantees could work, in a safe manner, where non-financial counterparties (NFCs) use gross omnibus accounts. This is because most NFCs do not use individually segregated accounts (in particular for ETDs).

We acknowledge that the consultation refers to "uncollateralized bank guarantees". We understand ESMA to use this term generically, and that any instrument – whether taking the form of a guarantee or uncollateralized letter of credit (LC) – would be eligible as long as it meets all the relevant requirements.

Prudential treatment of guarantees

We would also highlight that a separate issue arises under the prudential treatment of guarantees. We appreciate that these considerations are not within ESMA's remit, but we would encourage ESMA and the EBA to explore how the prudential treatment of bank guarantees may make it uneconomical for EU clearing members to accept guarantees as collateral.

European banks are not allowed to use bank guarantees to offset their credit exposure under CRR. EBA confirmed in a Q&A that these are to be treated as unfunded credit protection (see EBA Q&A 2015_1917[2]). As a result of this, there is a capital cost from accepting guarantees as collateral. ISDA emphasizes that these instruments, when used as CCP collateral, are subject to stringent regulation, under EMIR Article 47, as further specified under the draft RTS on which ESMA is consulting. This robust regulatory framework ensures their reliability as collateral, a point that should be considered in EBA's capital assessments as well.

Changes in relation to CCPs' investment policy

Noting that ESMA is revising Annex II of RTS 153/2013 in relation to CCP's investment policy, we would encourage ESMA to consider more broadly other type of highly liquid financial instruments that CCPs should be allowed to invest in, such as public debt constant NAV MMF funds where the underlying assets qualify as highly liquid financial instruments under Article 41(1) of EMIR and Annex II.

Please refer to the drafting suggestions on the proposed draft RTS, which we have included in the Annex submitted alongside our response (from page 12 in this document, and attached as a supporting document with the ESMA reply form).

[2] 2015_1917 Eligibility of unconditional Financial Letters of Credit as eligible financial collateral | European Banking Authority

Responses to questions

Q1. Do you agree that the existing provision on concentration limits should apply to guarantees and as such Article 42 should be amended to provide legal clarity on this?

We agree with ESMA's approach to amending Article 42 of RTS 153/2013, to provide further clarity on the application to guarantees of the existing requirements on concentration risk. It is crucial that the use of guarantees be governed by a robust concentration risk framework at the level of the CCP. The proposed addition to Article 42 helpfully extends the scope of current requirements for CCPs on concentration limits to guarantees, explicitly requiring that CCPs should determine conservative limits also in relation to guarantees, in terms of "economic sector, activity, geographic region" (per Article 42(3)(a)) as well as at the level of issuers and clearing members (per Article 42(2)).

We note that one of the eligibility conditions, as set out in Section 2 of Annex I, sets out that the guarantee should not introduce significant wrong way risk. In addition, Article 42(3)(a) sets out that concentration limits should consider, among other criteria, financial instruments and guarantees issued by issuers of the same type. We see these considerations as very important, for CCPs to ensure that guarantees, especially those issued by clearing members or their group entities, do not give rise to concentration, correlation or contagion risks that undermine the risk-segregating objectives of central clearing. Robust concentration limits – following Article 42, subject to the suggested changes, issuer credit-quality requirements – per the requirement under Section 2 of Annex I, and CCP-level oversight are therefore essential, where such structures are permitted.

With regards to CCP-level oversight specifically, we suggest requiring that the CCP seeks advice from the risk committee on the concentration limits applying to guarantees, also adding the following requirements to strengthen the risk management framework surrounding the use of guarantees (please see our suggested drafting in the draft RTS text included in Annex):

- under Article 42(8), to require CCPs to seek advice from the risk committee in relation to their concentration risk framework in relation to guarantees, explaining how they have taken into consideration the criteria set out under Article 42(3), (4), (5) and (6) in relation to guarantees;
- under Article 42(4), to require CCPs to define a limit on the proportion of their total collateral that may take the form of uncollateralised bank guarantees;
- under Article 53(4), to require CCPs to consider as part of their stress testing the consequence of a default of an issuing bank;
- under paragraph (f) of Annex I for bank guarantees (and similarly for other types of issuers), to require CCPs to test the capacity to draw on the guarantee, or to transfer it to the clearing member, at least on a yearly basis.

Finally, we suggest deleting the second sentence of Article 42(4), as the increase of the single issuer limit to 25% when 50% of collateral is in the form of commercial bank guarantees – already in the existing RTS – would potentially allow for outsized concentration on one single issuer.

Please refer to the drafting suggestions on the proposed draft RTS, which we have included in the Annex submitted alongside our response.

Q2. Do you agree with the inclusion of the level of collateralisation of the guarantee as a criterion for the CCP to consider when establishing concentration limits?

We are not aware of any potential meaningful use for collateralised bank guarantees. As a principle, while it could make sense to consider the level of collateralization, this specific RTS is about permitting uncollateralised bank guarantees for use by NFCs, who do not have readily available liquid collateral. If NFCs did have liquid collateral, they would likely be posting this directly rather than seeking guarantees.

Q3. Do you agree with the inclusion of the new criteria (e) in paragraph 3 of Article 42, so that the CCP can consider the activity of the non-financial client when setting concentration limits?

We agree with the inclusion of a new criteria (e) in paragraph 3 of Article 42, to specify that a CCP should consider the activity of the non-financial client when setting limits. We understand "activity" as referring to the sector in which the NFC operates. If guarantees are tagged with the client's name, a CCP should be able to take into account the sector in which the client operates when setting concentration limits.

From a systemic risk perspective, the CCP should ensure that the issuing bank is not over-exposed to risk in the same sector as the client applying for the guarantee. This is to ensure that CCPs consider potential sources of concentration risk at multiple level, as discussed in response to question 1, and set appropriate limits. This should be addressed through the definition of concentration limits that take into account the criteria set out under Article 42 paragraphs 3, 5, and 6.

Q4. Shall there be specific concentration limits established for guarantees provided by non-clearing members, given these exposures are not considered in the Stress Test?

We suggest that ESMA sets a specific concentration limit for guarantees provided by non-clearing members. The CCP should also seek advice from the risk committee, as part of discussions on the concentration risk framework, on the credit risk monitoring and limit framework that applies to non-clearing member issuers.

We also note that a guarantee provided by a non-clearing member would have the advantage of not being linked to any clearing member and therefore would not pose the risk of a double default situation (the client defaults and also the guarantor).

Q5. Is ESMA's understanding correct? Are there other essential features of the guarantees that should be highlighted?

We have a number of comments on the functioning of the guarantees as described by ESMA under paragraph 20.

Use of the guarantee to the benefit of the clearing member in the event of a client default

In paragraph 20, ESMA notes *"In case of a client default alone, considering that the CCP does not have a direct contractual relationship with the client, the guarantee should not be executed by the CCP unless the default of the client causes the clearing member to default on its obligations to the CCP".*

We have some comments on the description by ESMA of a mechanism where the guarantee is only executed by the CCP in the event of a default of the clearing member. The clearing member is

responsible for the client's performance and will collect margin accordingly. If the client defaults, the clearing member would manage the default, including using any posted collateral.

In the event a clearing member has accepted a construct where a client provides an uncollateralised bank guarantee, it appears unworkable if the clearing member is responsible for the performance of the client's account but does not have access to collateral, including guarantees. Unless the CCP relies upon the guarantee in a client default, the client is unlikely to benefit from this type of collateral because the clearing member is likely to call further collateral to cover its exposure to the client, which is not covered by the guarantee, or will not agree to the client posting a guarantee in the first place.

Therefore, the approach described by ESMA that a CCP can only call a guarantee where a clearing member defaults looks difficult to apply in practice. In order for this to be a realistic option for non-financial clients to use, there needs to be a reduction in the clearing member's exposure to the CCP and its non-financial client, as a result of the guarantee being posted as IM.

The only workable approach is to require that the guarantee comes with two beneficiaries: the CCP and the clearing member. This would allow the clearing member to rely on the guarantee in managing a client default, while ensuring that the CCP retains full protection in the event of a clearing member default. Such a structure supports risk reduction at both clearing member and CCP level and is consistent with the objectives of EMIR.

In any case, it should be emphasised that the type of collateral that a clearing member accepts from a client remains in the first instance a commercial and risk decision for the clearing member to make, within its own risk appetite and limit framework.

Unconditionality

It is important that the guarantee take the form of an autonomous, irrevocable, unconditional on-demand payment obligation that is not contingent on proof of loss or default, and that it can be honoured promptly. A structure that could only be triggered upon default would set a much higher bar for the clearing member to be able call on the guarantee, if they have to evidence that their client has defaulted. More importantly, such a structure increases overall risk by allowing that the guarantee only be accessed at a very late stage, when losses have already crystallised and liquidity pressures are most acute. In that situation, the guarantee would no longer function as an effective preventive risk-management tool, but rather as a last-resort instrument that may be triggered when it is almost too late to stabilise the default. In addition, it would prevent US FCMs from accepting such guarantees, as CFTC rule 1.43 may only accept letters of credit as collateral if the letter of credit may be exercised "regardless of whether the customer posting that letter of credit is in default in any obligation".

Form of the instrument: guarantee and letter of credit

We also note that where uncollateralised bank guarantees are used, such as in the US, the instrument takes the form of a letter of credit. We assume that any instrument that meets the conditions set out by EMIR Article 46, as further specified in the forthcoming RTS Annex I, will be eligible, regardless of whether they are labelled as an uncollateralised bank guarantee or a letter of credit.

Prudential treatment of the bank guarantee for a clearing member

Another essential consideration is the treatment of the bank guarantee for the clearing member. European banks are not allowed to use bank guarantees to offset their credit exposure under CRR. EBA confirmed in a Q&A that these are to be treated as unfunded credit protection (See EBA

Q&A 2015_1917[3]). As a result of this, there is a capital cost of accepting guarantees as collateral for EU clearing members.

Ultimately, the key question is whether these instruments are sufficiently reliable to reduce risk in a default situation. The answer should be consistent for both capital treatment and CCPs: either these instruments genuinely mitigate risk, or they do not. There should not be a discrepancy between their use for capital and their recognition by CCPs and clearing members.

Guarantees should operate as a reduction of credit exposure for the clearing member, essentially because payment to the CCP is irrevocably guaranteed up to the amount of the guarantee by the issuing bank. The client pays the issuing bank for a guarantee/letter of credit that meets all the applicable conditions. If the clearing member passes this through to the CCP as collateral, the clearing member's exposure to the CCP should reduce correspondingly.

Please refer to the drafting suggestions on the proposed draft RTS, which we have included in the Annex submitted alongside our response.

Q6. Do you agree with the conditions proposed by ESMA? Please provide your views specifically for each condition (a), (b), (c) and (d).

We use the article references in Annex I Section 2 of the proposed draft RTS, in relation to bank guarantees. Our comments apply for all guarantees.

Condition (a) sets out that the guarantee must be issued to guarantee a non-financial clearing member or a non-financial client. We agree with this condition.

Under condition (a), condition (ab) sets out that the beneficiary of a bank guarantee be the CCP. ISDA members ask that ESMA modifies this condition for clients that are clearing through a clearing member, to require that the guarantee must include two beneficiaries: both the CCP, and the clearing member. ESMA's current proposal significantly risks turning guarantees as eligible collateral at CCPs as unworkable in practice, thus undermining its intended aim to broaden the pool of eligible collateral. A clearing member must be able to enforce a bank guarantee directly in the case of a client default. If it cannot do so, the clearing member will be left with an unfunded exposure to the client while retaining full IM obligations to the CCP. This would also increase risk within the clearing system by making it more likely that a client default escalates into a clearing member default, rather than being contained at client level. This would therefore lead to the clearing member requiring further collateral from the client, which would negate the benefit to the client of being able to post an unfunded guarantee.

We note that condition (ab) also includes a possibility for these guarantees to "include a transfer clause, allowing under conditions to be defined by the CCP, the transfer of the beneficiary from the CCP to the clearing member of the client". We suggest to amend this sentence, to make it a requirement for guarantees to include two beneficiaries and a transfer clause, so that effectively, the guarantees has two beneficiaries, the CCP and the clearing member, and so that the clearing member can take the benefit where appropriate, such as where it has closed out the client's

[3] 2015_1917 Eligibility of unconditional Financial Letters of Credit as eligible financial collateral | European Banking Authority

positions at the CCP and settled any losses arising, leading to a claim against the client under the mirror trades between the clearing member and the client.

In addition, the requirement for the CCP to be the sole beneficiary, as currently proposed, would prevent US FCM from accepting such guarantees. Under CFTC Rule 1.43[4], a futures commission merchant (FCM) is prohibited from accepting a letter of credit as collateral if the derivatives clearing organization is the sole beneficiary. The FCM must be a beneficiary of the letter of credit to guarantee the authority to draw upon the funds in order to fulfil customer obligations.

Condition (b) sets out that the guarantee must be used by a CRR credit institution with a low credit risk based on the CCP's internal assessment, taking into consideration the risk arising from the establishment of the issuer in a particular country. We agree with this condition.

Condition (c) sets out that the guarantee is denominated in a currency that the CCP can adequately risk manage, or in a currency in which the CCP clears contract under an appropriate limit. We agree with this condition.

Condition (d) sets out that the guarantee must be irrevocable, unconditional and that the issuer cannot rely on any legal or contractual exemption or defence to oppose the payment of the guarantee. We agree with this condition, but suggest developing it further, to specify that these structures should be truly unconditional, once necessary procedural steps are satisfied. Please refer to our proposed drafting in the Annex.

We also have comments on condition (e), which sets out that the guarantee can be "honoured on demand within the period of liquidation of the portfolio of the defaulting clearing member". We suggest removing the reference to the liquidation period of the defaulted clearing member's portfolio. First, because the guarantee should be accessible in the event of a client default. Second because the reference to the liquidation period restricts the flexibility with which the CCP or the clearing member may choose to access the guarantee. For example, in the case of a client default, the clearing member might close out the client's position before drawing on the guarantee, such that in this scenario, the guarantee would have to be honoured outside of the liquidation period. The requirement should therefore be that the guarantee be honoured on demand within a short timeframe defined in the guarantee agreement.

Please refer to the drafting suggestions on the proposed draft RTS, which we have included in the Annex submitted alongside our response.

Q7. In relation to condition (c), do you agree with ESMA proposal? If not, is it in your opinion legally and practically feasible that guarantees are posted to an omnibus account?

We assume that ESMA refers to condition (aa) under condition (a) here, not condition (c).

Under condition (a), condition (aa) sets out that when the guaranteed is issued for a non-financial client, it must be posted to an individually segregated account (ISA) in the name of the non-financial client. While we appreciate that the mechanics of the guarantee are more straightforward to define with individually segregated accounts, a viable solution for clients using gross omnibus segregation accounts (GOSA) can be developed. Similar to existing practice in the US, LCs should be permitted in

[4] eCFR :: 17 CFR 1.43 -- Letters of credit as collateral.

a GOSA where client positions are maintained on a gross basis and the LC can be clearly attributed to a named client. Where guarantees are permitted to be used in a GOSA, CCPs should ensure that the relevant operational processes can be executed quickly and without ambiguity in a default scenario. This should include testing that the guarantee can effectively be called within the required timeframe.

In a GOSA, the clearing member will always know in respect of which client, and which positions the guarantee has been posted and, if the need arises, would be able to request that the CCP transfers the guarantee to their benefit. If the clearing member defaults, but not the client, the CCP would be able to draw on the guarantee, and the client would therefore still be solvent and able to make whole the issuer of the guarantee. In addition, currently, individually segregated accounts for ETD cannot be accessed by US FCMs and US clients. If that individual segregation requirement is maintained, FCMs and US clients would not be able to use guarantees at European CCPs.

Q8. Is there any other condition you consider would be necessary in relation to the extension of the use of guarantees to guarantee non-financial clients? E.g. should it be mandated that CCPs have in place a mechanism to identify the default of a non-financial client?

The extension of the use of guarantees should be approached with caution and be subject to robust safeguards. It would not be desirable to rely on guarantees that can only be drawn upon if a default event has occurred, or that would be slow to enforce.

At the same time, where 'bank guarantees' take the form of true LCs: that is, autonomous, irrevocable, unconditional on-demand payment obligations that are not contingent on proof of loss and can be honoured promptly, the associated execution and liquidity risks are materially lower and closer to established US CCP practice. In this context, it should be recognised that there is no substitute for appropriate liquid collateral, such as cash or high-quality securities, that is readily available to the CCP. Their effectiveness therefore depends critically on execution certainty and timing. Generic guarantees may introduce uncertainty as to both timing and outcome, whereas well-structured LC-type instruments can provide direct access to cash without reliance on stressed secondary market conditions (noting that LCs can only be recognised by way of a claim against the issuer, rather than monetised by sale in a secondary market which would be the usual way to recognise the value of funded collateral such as securities).

On ESMA's question regarding whether CCPs should have a mechanism to identify the default of a client: because a guarantee that would take the form of a LC can be used unconditionally, i.e. even absent an event of default of the non-financial client guaranteed, we do not see any need for CCPs to have a mechanism to identify the default of a non-financial client, especially as in the event of a client default, the CCP is usually not involved in the close-out of the client's positions and the CCP would look to the clearing member to settle any amounts due to the CCP consequent upon such close-out.

Q9. Do you agree with ESMA's proposal to require that there are a credit rating and reliable financial data on the guarantor available for the CCP to use in its internal assessment?

We agree with this proposal.

Q10. Do you consider that the direct access of a public guarantor to real-time gross settlement systems such as T2 should be a requirement for public guarantors? Please provide evidence or reasoning to support your response.

Guarantees need to be payable promptly. This may imply that the guarantor has access to T2, which could be achieved indirectly.

Q11. Do you agree that public guarantees should be accompanied by a legal opinion confirming the effective representation of the guarantor, the validity of the guarantee and its enforceability?

We support requiring public guarantees to be accompanied by a legal opinion confirming the effective representation of the guarantor, the validity of the guarantee and its enforceability.

Q12. Do you agree that the conditions for commercial bank guarantees should explicitly foresee that the guarantor is a credit institution as defined in CRR?

We agree with this requirement. This ensures that guarantors are subject to a harmonised prudential framework, including consistent capital, liquidity and supervisory requirements, thereby supporting a high level of confidence in their financial soundness.

Restricting eligible guarantors to CRR-defined institutions enhances legal certainty and the reliability of execution in stress scenarios. While certain aspects of bank resolution are harmonised at EU level, insolvency regimes remain only partially harmonised, and important differences persist across jurisdictions. These differences may affect the timing, enforceability and ultimate recovery of claims under a guarantee, particularly in a default or resolution scenario.

We do not support relying on third-country institutions as guarantors, as it would raise a number of practical issues, due to additional legal uncertainty, potential conflicts of law, and the absence of a common supervisory and resolution framework. This would question the extent to which CCPs and clearing members may be able to rely on structures issued by non-CRR institutions in a timely and certain manner. However, LCs issued by third-country credit institutions could be considered on an exceptional basis, provided that comprehensive legal review confirm the validity, enforceability and timely execution of the guarantee under all relevant laws.

Q13. Do you agree that the possibility for CCP to accept uncollateralised bank guarantees should be specified in Section two of Annex I of RTS 153/2013?

We agree with the proposed approach to amending Section two of Annex I of RTS 153/2013. Under current Section two of Annex I, paragraph (h) prevents the use of uncollateralized commercial bank guarantees. We would not suggest adding uncollateralized bank guarantees as a separate category in this section. Rather, we welcome the proposed approach which amends existing requirements on guarantees. Any necessary adjustments should focus on clarifying that references to bank guarantees are understood to cover only autonomous, irrevocable, unconditional on demand payment instruments, such as letters of credit, and not generic or bank guarantees contingent on default, which would in any case not meet the unconditionality criteria. Letters of credit represent a materially stronger structure than generic surety-type bank guarantees, and more closely align with established US CCP practice. Such instruments significantly reduce execution risk relative to traditional guarantees.

To avoid ambiguity as to the types of instruments that may be accepted, we suggest specific amendments to the conditions set out in Annex I, Section 2(1), and we also replicate similar amendments in the sub-sections relevant to central bank, public and public bank guarantees.

In particular, we suggest to add, after the condition on irrevocability and unconditionality, the requirement that "the guarantee shall constitute a primary and autonomous payment obligation of the issuing credit institution, independent of the validity, enforceability or performance of the underlying obligation", and that it "shall not be subject to any requirement to evidence default, loss, shortfall or insolvency, nor to any substantive legal or contractual defense that could delay payment."

We also suggest specifying that the guarantee should be honoured on demand and "promptly" within a short timeframe specified in the agreement, to align with established US CCP practice, where the time window within which the guarantor is expected to provide the funds is set out in the letter of credit agreement with the beneficiaries[5].

The liquidity characteristics of uncollateralised bank guarantees depend on their legal structure. Generic guarantees that cannot be reliably monetised on demand and promptly should be treated as non-liquid resources. Where LC-type instruments are accepted, CCPs should nevertheless demonstrate that reliance on such instruments does not impair their ability to meet liquidity needs in default scenarios.

Finally, it should be recognised that other types of collateral accepted by CCPs are subject to haircuts to reflect differences in liquidity, price volatility and execution risk. While LCs and other guarantees are not financial instruments, and are therefore not subject to haircuts under Article 41, this highlights that such instruments should not be treated as cash-equivalent. Their reliance on the creditworthiness and operational performance of the issuing bank means that they remain inherently different from funded, immediately realisable collateral. This is why the concentration framework surrounding the use of guarantees, as discussed in relation to Question 1, is crucial, ensuring that letters of credit are seen as complementary rather than interchangeable with cash or high-quality securities.

Please refer to the drafting suggestions on the proposed draft RTS, which we have included in the Annex submitted alongside our response.

Q14. Do you agree with ESMA that the conditions applicable to commercial bank guarantees should also be applicable to public bank guarantees? Please specify in your answer whether any addition condition should be considered.

We agree with ESMA's approach with regards to aligning the conditions applicable to public guarantees with the conditions applicable for commercial bank guarantees, which avoid unnecessary complexity. Our comments above in response to question 6 also apply in respect of public bank guarantees.

Q15. Do you agree with the proposed way to address the lack of definition of "public bank"?

[5] https://www.cmegroup.com/clearing/audit/files/rm_FU_Irrevocable_Standby_LOC920.pdf

We agree with ESMA's approach to clarify what can be considered as a "public bank" in the absence of an EMIR 3 definition, referring to "publicly owned" banks other than multilateral development banks listed under Article 117(2) of Regulation (EU) No 575/2013 and central banks. It would be helpful if ESMA could provide further context as to what type of institution they would expect to meet this proposed definition.

Q16. Do you agree with the proposed change concerning the conditions under which debt instruments can be considered highly liquid, bearing minimal credit and market risk (and hence considered as eligible financial instruments for the purpose of CCP investment policy)?

We agree with this proposed change, noting that it is essential that eligibility remains strictly conditioned on a high degree of liquidity and marketability, in line with existing requirements under Annex II, paragraph 1(b), (e) and (f). In particular, such instruments should only be considered eligible where they can be sold rapidly under stressed market conditions without a material impact on price. CCPs should therefore ensure that these instruments are actively traded in deep and liquid markets, with demonstrated resilience in periods of market stress. This is necessary to ensure that CCPs can convert investments into cash in a timely manner and maintain their ability to meet liquidity needs in a default scenario.

As a separate point, noting that ESMA is revising Annex II of RTS 153/2013, we would encourage ESMA to consider more broadly other type of highly liquid financial instruments that CCPs should be allowed to invest in, such as public debt constant Net Asset Value MMF funds where the underlying assets qualify as highly liquidity financial instruments under Article 41(1) of EMIR and Annex II.

Q17. Do you agree with the proposed change concerning the highly secure arrangements for the deposit of financial instruments posted as margins or as default fund contributions?

We agree with this proposed change.

We would also like to highlight a further important amendment that we believe should be made to this paragraph in relation to Article 44(1) of RTS 153/2013. As currently drafted, the provision creates an unintended inconsistency between the treatment of cash collateral and securities collateral.

Specifically, the framework imposes materially stricter limitations on the locations at which securities collateral may be held by CCPs and their members than those applicable to cash collateral. We recommend that the permissible holding arrangements for securities collateral be aligned with those for cash collateral. Maintaining differentiated treatment lacks a clear risk-based justification and unnecessarily constrains collateral mobility, limiting the efficient movement and use of securities across the market.

Absent this amendment, the EU collateral framework will remain unnecessarily fragmented, with tangible market consequences, including:

- reduced use of securities as collateral and increased reliance on cash;
- greater operational complexity and higher costs for market participants; and
- fragmentation of collateral pools, resulting in less efficient asset allocation.

Addressing this inconsistency would represent an important step towards facilitating access to CCPs, enhancing the efficiency of collateral provision, and strengthening the resilience and competitiveness of the EU financial system.

Finally, we note that the current RTS 153/2013 include two articles titled "Article 45" within Chapter XI "Investment Policy": Article 45 "Highly secured arrangements maintaining cash" and Article 45 "Concentration limits".

Please refer to the drafting suggestions on the proposed draft RTS, which we have included in the Annex submitted alongside our response.

ANNEX: ISDA DRAFTING SUGGESTIONS ON THE PROPOSED DRAFT RTS

ISDA's proposed edits are shown in red underline (additions) and ~~strikethrough (deletions)~~.

COMMISSION DELEGATED REGULATION (EU) .../...

of XX Month YYYY

amending Commission Delegated Regulation (EU) No 153/2013 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council as regards conditions for the acceptance of public guarantees and bank guarantees as collateral and changes to investment policy

(Text with EEA relevance)

THE EUROPEAN COMMISSION,
Having regard to the Treaty on the Functioning of the European Union,
Having regard to 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, and in particular Articles 46(3) and 47(8) thereof,
Whereas:

(1) Regulation (EU) No 2024/29876 amended Article 46 of Regulation (EU) No 648/2012 renewing the mandate for ESMA to set the relevant conditions under which public guarantees, public bank guarantees and commercial bank guarantees may be accepted as collateral by central counterparties (CCPs).
(2) Commission Delegated Regulation (EU) No 153/2013 lays down regulatory technical standards on requirements for CCPs, including as regards highly liquid collateral with minimal credit and market risk, investment policy and highly secure arrangements for the deposit of financial instruments posted as margins or as default fund contributions.
(3) Concentration limits set by CCPs in relation to eligible collateral should cover public and bank guarantees. Considering the specific needs of non-financial clients operating notably in commodity markets, CCPs should take into account the underlying activity of these entities, if communicated to the clearing member, when setting specific concentration limits for public and bank guarantees posted by these clients as collateral.
~~(4) Considering the specific contractual constructions of public guarantees, public bank guarantees and commercial bank guarantees cannot be commingled with collateral from other clearing~~

~~members of clients, therefore, when non-financial clients provide this type of guarantees as collateral, they should be posted to individually segregated accounts.~~

(5) Guarantees issued by public entities may be governed by public law requirements which might be difficult for the CCP to assess, having regard to the different jurisdictions where non-financial clients may be established. For this reason, in order to provide the required legal certainty to the CCP accepting this type of guarantees as collateral, the CCP should ask that the guarantee is accompanied by an independent legal opinion confirming effective representation of the public guarantor, the validity and the enforceability of the guarantee.

(6) In light of recent developments, it is also appropriate to update and amend certain provisions set out in Commission Delegated Regulation (EU) No 153/2013 with regard to investment policy and highly secure arrangements for the deposit of financial instruments posted as margins or as default fund contributions.

(7) In particular, due to the recent issuances by the Union of funding instruments (such as EU-bonds, EU-bills, NextGenerationEU Green Bonds and SURE social bonds) under the unified funding approach, which have benefitted from a high degree of market demand and confidence and high levels of market depth and liquidity, bearing minimal credit and market risk, it should be specified that debt instruments issued or explicitly guaranteed by the Union could be eligible financial instruments for the purpose of investment policy. In addition, in order to align the provisions on investment policy with Regulation (EU) No 575/20138, which assigns a 0 % risk weight for exposures to the Bank for International Settlements (BIS) and the International Monetary Fund (IMF), Commission Delegated Regulation (EU) No 153/2013 should also be amended to allow debt instruments issued or explicitly guaranteed by the BIS and the IMF to be eligible financial instruments for the purpose of investment policy.

(8) Furthermore, emission allowances having been classified as financial instruments in accordance with Directive 2014/65/EU 9 and considering that they can be accepted as collateral in accordance with Article 46(2) of Regulation (EU) No 648/2012, Commission Delegated Regulation (EU) No 153/2013 should also be amended to add the Union Registry referred to in Article 19(1) of Directive 2003/87/EC10 to the list of highly secure arrangements for the deposit of financial instruments posted as margins or as default fund contributions.

(9) This Regulation is based on the draft regulatory technical standards submitted by the European Securities and Markets Authority (ESMA) to the Commission.

(10) ESMA has developed the draft regulatory technical standards in cooperation with the European Banking Authority (EBA) and after consulting the European Systemic Risk Board (ESRB) and the European System of Central Banks (ESCB). In accordance with Article 10 of Regulation (EU) 1095/2010 of the European Parliament and the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority)11 , ESMA has conducted open public consultations on such draft regulatory technical standards, analysed the potential related costs and benefits and requested the advice of the Securities and Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010,

HAS ADOPTED THIS REGULATION:

Article 1

Amendments to Commission Delegated Regulation (EU) No 153/2013

Commission Delegated Regulation (EU) No 153/2013 is amended as follows:

(1) Article 39, first subparagraph is replaced by the following:

52. 'For the purposes of Article 46(1) of Regulation (EU) No 648/2012, financial instruments, bank guarantees, public guarantees and gold that meet the conditions set out in Annex I shall be considered as, highly liquid collateral.'

(2) Article 42, is amended as follows:

a. in paragraph 2, point (c) is replaced by the following:

53. 'type of asset or guarantee';

b. in paragraph 3, point (a) is replaced by the following:

54. 'financial instruments and guarantees issued by issuers of the same type in terms of economic sector, activity, geographic region;';

c. In paragraph 3, the following points are added:

i. '(d) the level of collateralisation of guarantees;'

ii. '(e) the underlying activity of the non-financial client.'

d. Paragraph 4 is replaced by the following:

'4. A CCP shall ensure that no more than 10 % of its collateral is guaranteed by a single credit institution, be it a commercial or a public bank, or equivalent third country financial institution, or by an entity that is part of the same group as the credit institution or third country financial institution. A CCP should define an overall limit on the total amount of collateral that can take the form of uncollateralized bank guarantees. ~~Where the collateral received by the CCP in the form of bank guarantees, from commercial or public banks, is higher than 50 % of the total collateral, this limit may be set up to 25 %.'~~

e. In paragraph 5, the word "guarantees" is added in the first sentence after "money-market instruments," ~~replaced by the following:~~

f. In paragraph 6, the words "or guarantees" are added after "its exposures to all financial instruments"

g. In paragraph 8, the following sentence is added after "limits.":

'A CCP that accepts guarantees shall seek advice from the risk committee in the review of its concentration limits in relation to guarantees, including how the relevant criteria set out under paragraph 3, and the requirements set out under paragraph 4, 5, and 6, have been taken into account.'

(3) In Article 44(1), the first sentence is modified as follows and the following point (d) is added:

'1. If a CCP ~~is unable to~~ does not deposit the financial instruments referred to in Article ~~45~~ xx or those posted to it as margins, default fund contributions or contributions to other financial resources, both by way of title transfer and security interest, with the operator of a securities settlement system that ensures the full protection of those instruments then such financial instruments shall be deposited with any of the following:'

…

'(d) the Union Registry referred to in Article 19(1), first subparagraph, of Directive 2003/87/EC in case of emission allowances referred to in Section C(11) of Annex I to Directive 2014/65/EU accepted by a CCP as collateral in accordance with Article 46(2) of Regulation (EU) No 648/2012.'

(3a) In Article 53(4), the following sentence is added after "considered.":

'Where the CCP accepts commercial bank guarantees, the CCP should consider in its stress tests the effect of a default of the issuing bank.'

(4) Annex I is amended in accordance with Annex I of this Regulation.

(5) Annex II is amended in accordance with Annex II of this Regulation.

Article 2

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

This Regulation shall be binding in its entirety and directly applicable in all Member States. Done at Brussels, DD MM YYYY,

For the Commission

The President

ANNEX I

Annex I to Delegated Regulation (EU) No 153/2013 is amended as follows:

(1) section 2 is replaced by the following:

'Section 2

Bank guarantees

1. A commercial bank guarantee, subject to limits set out by the CCP in application of Article 42 of this Regulation, shall meet the following conditions to be accepted as collateral under Article 46(1) of Regulation (EU) No 648/2012:

(a) it is issued to guarantee a non-financial clearing member or a non-financial client;

(aa) When the commercial bank guarantee is issued to guarantee a non-financial client, it must be posted to an individually segregated account at the name of the non-financial client or to a gross omnibus account;

(ab) Commercial bank guarantees issued to guarantee a non-financial client, shall have as ~~only~~ first beneficiary the CCP~~. These guarantees may~~ and, in the case of clients clearing through a clearing member, the clearing member as second beneficiary. In the latter case, the guarantee should include a transfer clause, allowing under conditions to be defined by the CCP, the transfer of the beneficiary from the CCP to the clearing member of the client;

(b) it has been issued by a credit institution as defined in Article 4(1)(1) of Regulation (EU) No 575/2013 that has low credit risk based upon an adequate internal assessment by the CCP. In performing such assessment the CCP shall employ a defined and objective methodology that shall not fully rely on external opinions and that takes into consideration the risk arising from the establishment of the issuer in a particular country;

(c) it is denominated in one of the following currencies:

(i) a currency the risk of which the CCP can demonstrate to the competent authorities that it is able to adequately manage;

(ii) a currency in which the CCP clears contracts, in the limit of the collateral required to cover the CCP's exposures in that currency;

(d) it is irrevocable, unconditional and the issuer cannot rely on any legal or contractual exemption or defence to oppose the payment of the guarantee. For the purpose of this point, the guarantee shall constitute a primary and autonomous payment obligation of the issuing credit institution, independent of the validity, enforceability or performance of the underlying obligation, and shall not be subject to any requirement to evidence default, loss, shortfall or insolvency, nor to any substantive legal or contractual defense that could delay payment;

(e) it can be honoured on demand promptly, within a defined time window as specified in the agreement between the issuing credit institution and the beneficiaries ~~the period of liquidation of the portfolio of the defaulting clearing member providing it~~ without any regulatory, legal or operational constraint or any third party claim on it;

(f) it is not issued by:

(i) an entity that is part of the same group as the non-financial clearing member or the non-financial client covered by the guarantee;

(ii) an entity whose business involves providing services critical to functioning of the CCP, unless that entity is an EEA central bank or a central bank of issue of a currency in which the CCP has exposures;

(iii) the clearing member of the non-financial client;

(g) it is not otherwise subject to significant wrong-way risk;

(h) when commercial bank guarantees are backed by collateral, that collateral shall meet the following conditions:

(i) it is not subject to wrong way risk based on a correlation with the credit standing of the guarantor or the non-financial clearing member or the non-financial client, unless that wrong way risk has been adequately mitigated by haircutting of the collateral;

(ii) the CCP has prompt access to it and it is bankruptcy remote in case of the simultaneous default of the clearing member and the guarantor.

(i) the capacity of the CCP to draw on the guarantee, and to transfer it to the clearing member under conditions to be defined by the CCP, is tested at least on a yearly basis.

2. A bank guarantee issued by a central bank shall meet the following conditions to be accepted as collateral under Article 46(1) of Regulation (EU) No 648/2012:

(a) it is issued by an EEA central bank or a central bank of issue of a currency in which the CCP has exposures;

(b) it is denominated in one of the following a currencies:

(i) a currency the risk of which the CCP can demonstrate to the competent authorities that it is able to adequately manage;

(ii) a currency in which the CCP clears transactions, in the limit of the collateral required to cover the CCP's exposures in that currency;

(c) it is irrevocable, unconditional and the issuing central bank cannot rely on any legal or contractual exemption or defence to oppose the payment of the guarantee. For the purpose of this point, the guarantee shall constitute a primary and autonomous payment obligation of the issuing central bank, independent of the validity, enforceability or performance of the underlying obligation, and shall not be subject to any requirement to evidence default, loss, shortfall or insolvency, nor to any substantive legal or contractual defense that could delay payment;

(d) it can be honoured on demand promptly, within a defined time window as specified in the agreement between the issuing central bank and the beneficiaries ~~the period of liquidation of the portfolio of the defaulting clearing member providing it~~ without any regulatory, legal or operational constraint or any third party claim on it;

3. A bank guarantee issued by a publicly owned bank not covered by paragraph 2 of this section, subject to limits set out by the CCP in application of Article 42 of this Regulation, shall meet the following conditions to be accepted as collateral under Article 46(1) of Regulation (EU) No 648/2012:

(a) it is issued to guarantee a non-financial clearing member or a non-financial client;

(b) when the public bank guarantee is issued to guarantee a non-financial client, it must be posted to an individually segregated account at the name of the non-financial client or to a gross omnibus account;

(c) public bank guarantees issued to guarantee a non-financial client shall have as ~~only~~ first beneficiary the CCP~~. These guarantees may~~ and, in the case of clients clearing through a clearing member, the clearing member as second beneficiary. In the latter case, the guarantee should include a transfer clause, allowing under conditions to be defined by the CCP, the transfer of the beneficiary from the CCP to the clearing member of the client;

(d) it has been issued by a publicly owned bank not covered by paragraph 2 of this section, that has low credit risk based upon an adequate internal assessment by the CCP. In performing such assessment the CCP shall employ a defined and objective methodology that shall not fully rely on external opinions and that takes into consideration the risk arising from the establishment of the issuer in a particular country;

(e) it is denominated in one of the following currencies:

(i) a currency the risk of which the CCP can demonstrate to the competent authorities that it is able to adequately manage;

(ii) a currency in which the CCP clears contracts, in the limit of the collateral required to cover the CCP's exposures in that currency;

(f) it is irrevocable, unconditional and the issuer cannot rely on any legal or contractual exemption or defence to oppose the payment of the guarantee. For the purpose of this point, the guarantee shall constitute a primary and autonomous payment obligation of the issuing public bank, independent of the validity, enforceability or performance of the underlying obligation, and shall not be subject to any requirement to evidence default, loss, shortfall or insolvency, nor to any substantive legal or contractual defense that could delay payment;

(g) it can be honoured on demand promptly, within a defined time window as specified in the agreement between the issuing public bank and the beneficiaries ~~the period of liquidation of the portfolio of the defaulting clearing member providing it~~ without any regulatory, legal or operational constraint or any third party claim on it;

(h) it is not issued by:

(i) an entity that is part of the same group as the non-financial clearing member or the non-financial client covered by the guarantee;

(ii) an entity whose business involves providing services critical to functioning of the CCP, unless that entity is an EEA central bank or a central bank of issue of a currency in which the CCP has exposures;

(iii) the clearing member of the non-financial client;

(i) it is not otherwise subject to significant wrong-way risk;

(j) unless otherwise specified by the operating rules of the CCP in application of the third subparagraph of Article 46(1) of EMIR, public bank guarantees are fully backed by collateral that meets the following conditions:

(i) it is not subject to wrong way risk based on a correlation with the credit standing of the guarantor or the non-financial clearing member or the non-financial client, unless that wrong way risk has been adequately mitigated by haircutting of the collateral;

(ii) the CCP has prompt access to it and it is bankruptcy remote in case of the simultaneous default of the clearing member and the guarantor.'

(2) In Annex I, Section 2a is replaced by the following:

'SECTION 2a

Public guarantees

A public guarantee that does not meet the conditions for a central bank guarantee set out in Section 2, paragraph 2, shall meet all of the following conditions to be accepted as collateral under Article 46(1) of Regulation (EU) No 648/2012:

(a) it is issued to guarantee a non-financial clearing member or a non-financial client;

(aa) when the public bank guarantee is issued to guarantee a non-financial client, it must be posted to an individually segregated account at the name of the non-financial client client or to a gross omnibus account;

(ab) public guarantees issued to guarantee a non-financial client shall have as ~~only~~ first beneficiary the CCP~~. These guarantees may~~ and, in the case of clients clearing through a clearing member, the clearing member as second beneficiary. In the latter case, the guarantee should include a transfer clause, allowing under conditions to be defined by the CCP, the transfer of the beneficiary from the CCP to the clearing member of the client;

(b) it is explicitly issued or guaranteed by any of the following:

(i) a central government in the EEA;

(ii) regional governments or local authorities in the EEA, where there is no difference in risk between exposures of regional governments or local authorities and the central government of that Member State because of the specific revenue-raising powers of the former, and the existence of specific institutional arrangements the effect of which is to reduce their risk of default;

(iii) the European Financial Stability Facility, the European Stability Mechanism, or the Union, where applicable;

(iv) a multilateral development bank as listed under Article 117(2) of Regulation (EU) No 575/2013 of the European Parliament and of the Council (7) and established in the Union;

(c) the CCP can demonstrate that it has low credit risk based upon an internal assessment by the CCP;

(d) the public guarantor respects the conditions determined by the risk management framework of the CCP;

(e) it is denominated in one of the following currencies:

(i) a currency the risk of which the CCP can demonstrate to the competent authorities that it is able to adequately manage;

(ii) a currency in which the CCP clears transactions, in the limit of the collateral required to cover the CCP's exposures in that currency;

(f) it is irrevocable, unconditional and the issuing and guaranteeing entities cannot rely on any legal or contractual exemption or defence to oppose the payment of the guarantee. For the purpose of this point, the guarantee shall constitute a primary and autonomous payment obligation of the issuing public entity, independent of the validity, enforceability or performance of the underlying obligation, and shall not be subject to any requirement to evidence default, loss, shortfall or insolvency, nor to any substantive legal or contractual defense that could delay payment;

(g) it can be honoured on demand promptly, within a defined time window as specified in the agreement between the issuing public entity and the beneficiaries ~~the period of liquidation of the portfolio of the defaulting clearing member providing it~~ without any regulatory, legal or operational constraint or any third party claim on it.

For the purposes of point (c), the CCP shall employ, in performing the assessment referred to in that point, defined and objective methodology that shall not fully rely on external opinions. The assessment shall also include credit ratings or other publicly available financial information of the guarantor.

For the purposes of points (f) and (g), the public guarantee shall be accompanied by a written legal opinion confirming the enforceability and validity of the guarantee and any related payment agent agreement under the applicable law. The legal opinion shall, at a minimum, confirm that:

(i) the public guarantor has the legal capacity and authority to issue the guarantee and enter into any related agreements, and that all necessary permits and approvals have been obtained;
(ii) the guarantee and any related payment agent agreement create legally valid and enforceable payment obligations on first demand, and that the choice of law and jurisdiction clauses are recognized under the legal framework governing the public guarantor and the payment agent;
(iii) the guarantee and any related agreements cannot be contested, revoked, or otherwise rendered non-binding after execution; and

(iv) the CCP's rights under the guarantee and any related agreements can be judicially asserted and enforced without restrictions, waiting periods, or special authorizations, and that the agreed venue for enforcement is legally recognized.'

ANNEX II

Annex II to Delegated Regulation (EU) No 153/2013 is amended as follows:

(1) In paragraph 1, point (a), of Annex II to Commission Delegated Regulation (EU) No 153/2013, the following sub-points are added:

'(v) the Union;

(vi) the Bank for International Settlements;

(vii) the International Monetary Fund.'

About ISDA

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