

Response Form to the Consultation Paper

Draft RTS on the requirements for independent valuers, the methodology for assessing the value of the assets and liabilities of a CCP, the separation of the valuations, the buffer for additional losses to be included in provisional valuations and the methodology for carrying out the valuation for the purpose of the ‘no creditor worse off’ principle (Articles 25(6), 26(4) and 61(5) of CCPRRR)

Responding to this paper

ESMA invites comments on all matters in this consultation paper and in particular on the specific questions summarised in Annex III. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **24 January 2022**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

1. Insert your responses to the questions in the Consultation Paper in the present response form.
2. Please do not remove tags of the type <ESMA_QUESTION_VLTN_1>. Your response to each question has to be framed by the two tags corresponding to the question.
3. If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.
4. When you have drafted your response, name your response form according to the following convention: ESMA_VLTN_nameofrespondent_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA_VLTN_ABCD_RESPONSEFORM.
5. Upload the form containing your responses, in Word format, to ESMA's website (www.esma.europa.eu under the heading "Your input – Open consultations" → "Consultation on Valuation of CCPs assets and liabilities in resolution").

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you

do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading [Legal Notice](#).

Who should read this paper?

All interested stakeholders are invited to respond to this consultation. In particular, this paper may be specifically of interest for EU central counterparties, clearing members and clients of clearing members.

General information about respondent

Name of the company / organisation	Futures Industry Association and International Swaps and Derivatives Association
Activity	Banking sector
Are you representing an association?	<input checked="" type="checkbox"/>
Country/Region	International

Introduction

Please make your introductory comments below, if any

<ESMA_COMMENT_VLTN_00>

The Futures Industry Association (FIA) and the International Swaps and Derivatives Association (ISDA), together the Associations, represent the largest number of global and national participants in clearing, banking and financial markets. The Associations appreciate this opportunity to comment on this consultation.

We applaud ESMA for its enormous efforts and impressive work it has delivered on the consultations on CCP resolution, providing a thorough and comprehensive analysis for each of them.

Our key points in this response are twofold:

1. We have concerns regarding the valuation of the No-Creditor-Worse-Off (NCWO) principle. Mostly driven by Level 1 of CCPRRR, the counterfactual to resolution includes many components, for instance replacement costs or margin funding for re-establishing positions at another CCP that are not present in the NCWO safeguard in other jurisdictions and that are extremely difficult to value.
2. We fully agree with the requirements for the valuer to be independent but are concerned that the pool of eligible valuers will be limited.

This consultation response covers the positions of our members that are clearing members and their clients. The paper does not reflect the views of many CCPs, and many of the CCPs are in disagreement with the views expressed herein.

About FIA

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. Our membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from about 50 countries as well as technology vendors, law firms and other professional service providers.

Our mission: To support open, transparent and competitive markets, protect and enhance the integrity of the financial system, and promote high standards of professional conduct.

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 960 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. Follow us on Twitter, LinkedIn, Facebook and YouTube.

<ESMA_COMMENT_VLTN_00>

Questions

Q1 : Do you agree with the proposed approach to define three elements of independence that should be met for a valuer to be deemed to be independent from the CCP and the resolution authority?

<ESMA_QUESTION_VLTN_01>

We agree with the proposed approach to define three elements of independence that should be met by a valuer to be deemed independent of the CCP and the resolution authority (RA). Each of the three elements makes sense on its own.

However, and as we explain in the response to question 2, we are concerned that the definition of relevant entity will include too many market participants, which will make it difficult to identify qualified, experienced valuers, who have not worked at or for a clearing member firm or a CCP before and would be deemed not to be independent.

<ESMA_QUESTION_VLTN_01>

Q2 : Do you agree with the proposed definitions for the relevant entity, relevant authority and independent valuer?

<ESMA_QUESTION_VLTN_02>

We believe that all definitions on their own are suitable and sensible. However, we have concerns with the definition of a “*relevant entity*”.

While we agree that the valuer should not only be independent from the CCP itself, but also from clearing members and clients will mean that the valuer needs to be independent from the whole marketplace served by the CCP. Any potential valuer who is experienced with cleared exposures may have undertaken an audit or other work for at least one of them in the preceding year. For regional CCPs, the RA could utilise valuers from other jurisdictions, although paragraph 53 makes this challenging as the firm the valuer has had a close relationship with is likely to have an audit relationship with other CCPs. For regional or global CCPs, utilising valuers from other jurisdictions will be very difficult.

We generally agree with ESMA’s approach of defining independent valuers and acknowledge that it will be difficult to have a sufficient pool of potential valuers while at the same time ensuring independence. The pool of available valuers could be potentially widened if some size thresholds were to be applied, i.e. a valuer might still be deemed independent if he/she audited a clearing member that fits under a threshold in terms of initial margin. Another option would be to shorten the applicable

time frame within which a valuer is not permitted to perform audits or provide consulting services.

In addition, paragraph 28 states that “*the persons concerned have the qualifications, experience, ability, knowledge and resources to ensure that they can perform the valuation without depending on support from third parties*”. We recommend providing more clarity concerning the reliance on market data supplied either i) directly from clearing members, or ii) indirectly from clearing members via a third party/platform, and that both would be excluded from the scope of “*support from third parties.*”

We believe that these requirements in addition to the 3-year requirement in 44(d) are in conflict with the aim of paragraph 59, which notes that “*the list should not be too limited as this could create a problem in a time sensitive situation where valuations should be done effectively and urgently*”.

Another option would be for the RA, as a first step endeavour, to identify a valuer that satisfies all conditions proposed in this RTS. In case an insufficient number of suitable candidates are available, we propose to establish a fallback along the lines suggested above. We agree that the RA can establish this list in advance and not only at the time when a valuer is needed.

<ESMA_QUESTION_VLTN_02>

Q3 : Do you agree with the proposed conditions to assess whether a person considered for the position of independent valuer or appointed as independent valuer does not have an actual or potential material interest in common or in conflict with any relevant public authority or the CCP?

<ESMA_QUESTION_VLTN_03>

We agree with the proposed conditions, subject to the issue that conditions that are too restrictive could limit the pool of available and suitable valuers. (see question 2).

<ESMA_QUESTION_VLTN_03>

Q4 : Do you agree with the proposed conditions to assess whether a person considered for the position of independent valuer or appointed as independent valuer has the necessary qualifications, experience, ability, knowledge and resources?

<ESMA_QUESTION_VLTN_04>

We very much agree that aspects of CCPs are important, like skills and knowledge of clearing, post-trading, prudential supervision and financial matters, as well as of experience relevant to CCP supervision and regulation.

Resolution of a CCP is extremely time critical, and the valuer should already be familiar with the details of clearing and surrounding regulation.

However, we note that the requirement under paragraph 64 that the “*person should be qualifying as a statutory auditor or audit firm*”, alongside the requirement already noted regarding paragraph 53, creates a universe of appropriate persons that may be unrealistic, especially with respect to the timeliness required to identify a suitable individual that does not fail to meet the requirements of these or other clauses.

We would also welcome clarity with regard to paragraph 67 where the valuer shall “*not seek or take any instructions or guidance from any relevant public authority or the relevant entity*”, that using market data or price submissions, originating from clearing members or clients, for the purpose of, or for inputs into a valuation, would not fall into the scope of this requirement, especially given paragraph 89(d) makes specific reference to market data.

<ESMA_QUESTION_VLTN_04>

Q5 : Do you agree with the proposed approach to determine and assess the three elements of independence to conclude if a valuer shall be deemed to be independent from the CCP and the resolution authority?

<ESMA_QUESTION_VLTN_05>

We agree with the separation of the requirements of the valuer from both the relevant public authority and relevant parties.

<ESMA_QUESTION_VLTN_05>

Q6 : Do you agree with the respective proposed approaches for the valuation under Article 24(2) and Article 24(3) of Regulation (EU) 2021/23?

<ESMA_QUESTION_VLTN_06>

We agree with the proposed approach for the valuation under Article 24(2) and Article 24(3).

Contrary to a regular business or even a bank, the valuation of a CCP in resolution is highly dependent on market prices of the transactions cleared by the CCP, collateral collected by the CCP and losses that result in resolution. Compared to the clearing

exposures, the actual value of the CCP's business (buildings, computers etc) is usually significantly lower.

Valuation of a CCP is therefore highly time-dependent and needs to be largely automated, as far as clearing assets are involved.

We recommend, as part of the resolvability assessment, that the RA ensures that relevant information can be easily queried from CCP systems.

<ESMA_QUESTION_VLTN_06>

Q7 : Do you agree with the described process for performing the 'No Creditor Worse Off' Valuation in accordance with Article 61 of Regulation (EU) 2021/23?

<ESMA_QUESTION_VLTN_07>

Performing the No Creditor Worse Off (NCWO) valuation is extremely difficult.

As the consultation (paragraph 96) states, losses in resolution will only be different from losses in the counterfactual if the RA decides to diverge from the rules defined by the CCP with regard to recovery or if the CCP rules include specific treatments for service closure or insolvency proceedings that are not considered under resolution. However, a number of CCPs' rulebooks include special clauses for service closure. Also, CCPRRR gives the RA a lot of scope to deviate from the rulebook (otherwise the RA could have relied on recovery). It is therefore likely that the treatment in resolution will differ from that under the counterfactual.

We overall agree with the process proposed, even though this process leaves multiple detailed questions to the valuer.

We agree that the most significant and direct costs incurred by clearing members are the losses stemming from market moves between the time net positions are closed by the CCP and the time they are reopened, as well as liquidity and concentration costs associated with the reopening of these net positions. We however believe that there could be circumstances where the time difference between these two events will be very short, as clearing participants could consider re-hedging themselves as soon as they deem the existing hedges at a CCP likely to be in default proceeding not to be effective. Please see also the response to question 8 that describes that firms will not re-hedge themselves in a uniform fashion.

We very much welcome that ESMA discarded the use of extreme proxies for replacement costs like initial margin.

As proposed at paragraph 110, the valuer could use as many observations as possible from resolution, assuming that the recovery plan would have allowed the CCP to use similar tools and taking path-dependency into account. For instance, the

impact of VMGH for each clearing participant will depend on the day VMGH is enacted.

Overall, we agree that the valuer will have to follow a simplistic approach, as long as this simplistic approach results in fair estimates.

<ESMA_QUESTION_VLTN_07>

Q8 : Question 8: Do you agree with the proposed list of direct replacement costs to be included in the NCWO valuation?

<ESMA_QUESTION_VLTN_08>

With respect to Article 25 of the draft RTS, we strongly disagree with the concept of including commercially reasonable replacement costs in the calculation as described in the draft Article 24 RTS. While we appreciate that ESMA has a mandate to draft standards to determine such replacement costs, there are significant practical challenges in deriving a reasonable estimate of what such cost would be, given the number of assumptions a valuer would need to make. To provide some examples:

Some market participants may reinstate their positions if their existing positions would have been closed out due to a CCP's insolvency. However, this may be done through other instruments (e.g., a future versus a swap), this may be done in tranches and therefore over time, this might not be done at all (as the hedge is no longer needed as both the client position mirroring the house position have been closed out due to liquidation), or this may be done bilaterally or at CCPs elsewhere in the world. It is nearly impossible to determine the replacement cost and the cost of funding for margin should positions be reinstated, as this depends how many other market participants would reinstate their positions at the same alternate venue at the same time. Therefore, any assumptions on concentrated positions cannot be made with confidence as this is highly dependent on the behaviour of the market as a whole and not solely of one or two market participants. In addition, there could be offsetting positions or other portfolio effects which decrease overall margin requirements at the alternate CCP. Moreover, the cost of funding (for initial margin) is different for each clearing member: the cost may be negative for some and positive for others. Finally, there could be market circumstances that would warrant market participants to not replace their liquidated positions within a reasonable timeframe as participants prefer to see the market stabilize first, which could take some time.

These reasons amongst others indicate the significant challenges in deriving a reasonable estimate of replacement costs given the many variables involved. As a result, we strongly recommend that ESMA formulates standards that would minimize the outcome of any replacement cost calculation.

Having said that, and acknowledging that ESMA will feel bound by Level 1 rules, we make some more detailed comments to the proposed rules:

We agree that the direct replacement cost would be mainly the difference in valuation of the positions at the old CCP and the price at which these could be re-opened. As mentioned in the response to question 7, we believe that the time difference between these two events (insolvency at the old CCP and re-hedging) will be very short, as clearing participants will re-hedge themselves as soon as they deem the existing hedges at a CCP likely to be in default proceeding not to be effective. Some firms might use other hedging strategies or decide not to re-hedge at all.

In any case, it will be very hard to proxy for replacement costs if these are not actually incurred.

Please find below some comments and request for clarification relating to the additional costs in article 25 (2):

- a) We are not clear what is meant with the “hypothetical credit exposures of the clearing members to the CCP at the time of replacing the net positions” and what cost would be attached to credit exposures.
- b) On liquidity and concentration cost, a good proxy would be the margin add-ons that the old CCP was charging for liquidity and concentration, unless the add-ons of a likely fallback CCP are well known. We also want to highlight that these are not direct cost, but margin to be posted. Additional cost for clearing participants would only be the funding cost for this margin.
- c) On fees, we would argue that ongoing fees that are linked to transaction flows would have been incurred in a similar way by the wound down CCP. Cost for becoming a member or client of a member at the fall-back CCP will depend on whether there is already a membership – especially large firms already maintain multiple clearing memberships. In addition, one cannot become a new member of an alternative CCP overnight. As a result, it is questionable if these costs can be measured in a timely fashion.
- d) The funding cost for differences in margin requirements and default fund contributions shouldn't be material, as margin and default fund of similar efficiently managed CCPs would not be too different – and the cost is merely funding cost, not the amount of collateral itself. It is also a temporary cost, as clearing members will at some point receive their margin back from the wound down CCP.

The impact on margin requirements will also be different for each clearing member because of portfolio effects. Margin requirements do not even need to increase – they could also decrease. How margin requirements change will also depend on the CCP selected by each clearing member as a fall-back (please also see the comments on re-hedging under question 8 above).

While we appreciate that some of these cost elements to be taken into account stem from the CCPRRR level 1 mandate, we note that most of these additional costs are very difficult to estimate. Also, by inflating the cost of the counterfactual, the NCWO safeguard in EU regulation will be less effective compared to the NCWO safeguard in other jurisdictions.

<ESMA_QUESTION_VLTN_08>

Q9 : Do you agree with the proposed approach for the calculation of the buffer for additional losses to be included in provisional valuations?

<ESMA_QUESTION_VLTN_09>

We believe that the proposed approach for the calculation of a buffer is not sufficiently adapted to CCPs. For instance, extrapolating “*average losses estimated for assets of peer competitors*” is sensible in bank resolution, but we cannot see how this would be helpful in estimating a buffer for CCP resolution, given that resolution of a CCP is expected to be a singular event in the market.

Other than that, the approach is very generic and leaves much to the discretion of the valuer. We agree with this approach, as this buffer is for unexpected losses which cannot be codified in advance.

<ESMA_QUESTION_VLTN_09>

Q10 With regards to the proposed policy options for the circumstances for the independent valuer to be deemed independent, do you agree with Option 2? If not please explain? Have you identified other benefits and costs not mentioned above associated to the proposed approach?

<ESMA_QUESTION_VLTN_10>

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<ESMA_QUESTION_VLTN_10>

Q11 If you advocate for a different approach, how would it impact the cost and benefit assessment? Please provide details

<ESMA_QUESTION_VLTN_11>

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<ESMA_QUESTION_VLTN_11>

Q12 With regards to the proposed policy options for the information to be used in valuation, do you agree with Option 2? If not please explain? Have you identified other benefits and costs not mentioned above associated to the proposed approach?

<ESMA_QUESTION_VLTN_12>

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<ESMA_QUESTION_VLTN_12>

Q13 If you advocate for a different approach, how would it impact the cost and benefit assessment? Please provide details.

<ESMA_QUESTION_VLTN_13>

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<ESMA_QUESTION_VLTN_13>

Q14 With regards to the policy options for the measurement basis, do you agree with proposed mixed approach? If not please explain? Have you identified other benefits and costs not mentioned above associated to the proposed approach?

<ESMA_QUESTION_VLTN_14>

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<ESMA_QUESTION_VLTN_14>

Q15 If you advocate for a different approach, how would it impact the cost and benefit assessment? Please provide details.

<ESMA_QUESTION_VLTN_15>

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<ESMA_QUESTION_VLTN_15>

Q16 With regards to the proposed policy options for the buffer for additional losses in provisional valuations, do you agree with Option 2? If not please explain? Have you identified other benefits and costs not mentioned above associated to the proposed approach?

<ESMA_QUESTION_VLTN_16>

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<ESMA_QUESTION_VLTN_16>

Q17 If you advocate for a different approach, how would it impact the cost and benefit assessment? Please provide details.

<ESMA_QUESTION_VLTN_17>

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