

**Eurex Clearing Response**

**to**

**the CPMI and IOSCO discussion paper on  
client clearing: access and portability**

Frankfurt, 7 February 2022

## A) Introductory Remarks

Eurex Clearing is an EMIR authorized central counterparty (CCP) and provides clearing services for cash and derivatives markets in listed and over-the-counter (OTC) financial instruments. We welcome the CPMI and IOSCO stocktaking exercise and identification of effective practices and potential next steps in relation to access to central clearing and portability. Therefore, we appreciate the opportunity to provide feedback to the joint working group's discussion paper on client clearing and trust that our comments are seen as a useful contribution to progress on this front.

### Access

With regard to the discussion paper's findings about direct and sponsored access models, Eurex Clearing has invested heavily in direct and sponsored access as we expect them to have a positive impact on the clearing landscape providing an alternative to traditional client clearing with mutual economic, risk management and operational benefits for agents, sponsors, and participants. With ISA Direct, we are also offering a direct access model to clients to clear OTC IRS and repos and plans to introduce ISA Direct Indemnified as an additional access model for repos, increasing safety and robustness through reduced concentration and improved portability. We expect direct access and sponsored access clearing models to co-exist alongside traditional client clearing, and the rate of adoption will depend on individual asset classes, regulatory changes and/or the evolution of the models.

In this context, it is important to note that their development and adoption are at a very early stage. Eurex Clearing would like to clarify that sponsored access models are available as well for small-to-medium sized clients, and offer a promising new avenue to support clearing accessibility. Generally, those models are designed to address specific risk management and resource management (capital, funding and liquidity, and economic returns) challenges faced by general clearing members in respect of traditional client clearing. Therefore, the current greater use by larger and more sophisticated clients and in the repo market is a natural consequence of the risk management and operational benefits to the client, and economic benefits to the general clearing member that continues to act as a clearing agent for the client. While repo has been the most successful use case for direct access models so far, these also offer significant benefits for other asset classes such as OTC and exchange-traded derivatives. Furthermore, greater accessibility to direct and sponsored access models should only be enabled to the extent possible depending on the risk profile of market participants and depending on the clearing member and client's risk and resource management objectives.

Notwithstanding the above, **Eurex Clearing believes that there is more scope for innovation in how to optimize credit, market, operational, legal and funding / liquidity risk management constraints.** As an example, direct access and sponsored access models could be further enhanced and the utility improved if third parties are able to directly cover the day-to-day funding of margin requirements of direct access participants, thereby reducing the liquidity, legal and operational burdens of meeting CCP margin requirements. **We have highlighted further important aspects that should be considered for improving greater use of access models in our answers to questions 4 and 11.**

As a CCP offering access models, Eurex Clearing is of the view that CCPs have introduced sufficient safeguards to prevent risk transmission from direct participants using direct and sponsored access models. Fundamentally, the risks generated by direct access are identical to those arising from a standard clearing membership. Therefore, Eurex Clearing developed its access models with the same high risk management standard as for other clearing members. In

addition, a sponsor default is managed adequately, as it is, in a worse-case scenario, equivalent to the default of a clearing member. Further, we believe sponsors are properly incentivized to closely monitor the activity of their sponsored participants. We have also tested our access models and those exercises have been successful proving the robustness of the Default Management Process and raising awareness on the indemnifying topic on member's trading desk level as well as awareness of challenges in regards of porting client positions under different access models. Further, it is important to note that the current number of agents and sponsors available is again reflective of the stage of market development.

Accordingly, **the challenges around the adoption of direct and sponsored access models have more to do with the prevailing market structure around client clearing and the economic incentives to switch, rather than with potential risks associated with access models, availability of sponsors or the design of access models.**

### **Portability**

Regarding CPMI IOSCO's considerations about porting, Eurex Clearing generally agrees with the tools identified in the discussion paper as potentially successful porting practices. However, we would like to pick up the standard setters' finding that regulatory frameworks for porting differ across jurisdictions, meaning that many of the tools or practices described in the discussion paper are therefore not applicable for Eurex Clearing operating under the EU regime (e.g. game plans).

Noting that CPMI IOSCO has addressed the majority of the recommended next steps to CCPs, we would like to emphasize that CCPs (as well as clearing members and clients) can only take minor steps themselves to enhance porting procedures within the given regulatory framework. **For truly making progress in increasing the likelihood of successful porting, regulatory changes of local regimes will be necessary to address current hurdles and restrictions for both CCPs and clearing members/CCSPs.**

In our answers to questions 15, 21 and 31 we have outlined a number of potential measures to address barriers impeding effective porting, increasing the likelihood of successfully porting clients and avoiding market impact following a clearing member default:

- **Fostering awareness and preparedness:** One of the crucial factors is for clients as well as potential replacement CCSPs to be prepared, i.e. to be familiar with porting processes and requirements. In this context, Eurex Clearing considers it important to ensure transparency which steps need to be taken by the parties involved in case of a CCSP default. A detailed description of the porting process and necessary requirements is therefore available on our website. Further, Clients and clearing members are invited to participate in porting exercises to test these procedures with a view to fostering preparedness. We believe that the introduction of porting exercises within the EMIR fire drill framework could be considered to further improve awareness and preparedness by the industry.
- **Relief for clearing members/CCSPs' hurdles and restrictions:** Another crucial factor relates to the cost for clients (especially smaller ones) of maintaining multiple relationships to clearing members to ensure a back-up CCSP for the porting phase as clearing members only tend to accept clients in case of a default to which they have already established a relationship. A standing relationship does however not necessarily mean that the back-up CCSP will take on the client's business – this may rather depend on the back-up CCSP's risk appetite and financial or operational resource capacities, etc. This is closely linked to

current regulatory requirements such as strict client consent or KYC provisions, as alluded to in the discussion paper, which render a swift process of accepting clients in case of a default impossible. **Allowing for temporary waivers of KYC, AML, and capital requirement for clearing members and CCPs in the porting phase would therefore remove major hurdles and increase the likelihood of porting also for clients without alternate CCSPs.**

- **Review of client consent mechanisms: Importantly, porting could be further streamlined and facilitated if the porting process would be changed to a process that would allow the CCP to execute the porting process without the positive ex-ante consent by the client.** Under EU law, porting depends on client consent, while in the US, the LSCO-rules foresee that porting is organized by the regulators and insolvency administrator of the defaulting clearing member while the CCP and the potential replacement clearing member execute. **For facilitating the porting process under EU law (i.e. EMIR) the same technique as foreseen under the LSOC-Rules could be implemented, stating that the porting process shall be organized by regulators and the insolvency administrator and executed by the CCP in cooperation with the replacement clearing member. Such procedure would speed up the porting process and would also facilitate the liquidation process for the CCP.**
- **Differentiating client types and account structures for a meaningful increase of portability:** Unless the insolvency administrator and/or the regulatory authorities are driving the porting process, the probability of porting will significantly differ from one client to another. In this context it is important to consider that there are different types of clients, and, consequently, different degree of sophistication, clearing models, as well as the nature of the business of the client. In order to obtain good porting likelihood, a client would need to be on a gross-margined model, maintain multiple clearing relationships, and develop adequate procedures, all of which come at a cost. Requiring all clients to maintain this degree of sophistication would be detrimental to the ambition of easing access to central clearing to smaller entities. Such costs are likely disproportionate in particular for institutions with low interest in porting. Additionally, granting sufficiently long porting period to accommodate clients with low porting likelihood can only be done at the risk of the broader clearing community, as the market move during the period will be borne by the lines of defence. Considering the EU regulation, increasing porting likelihood for all customers to the same extent might not be the right path. **Unless the local regime would converge toward the US model in relation to client consent provisions, there should be differentiated porting periods and frameworks for different business segments, clearing models and client types, fostering porting for those with adequate set-up, and ensuring optimal orderly liquidation in case porting fails for the others.**
- **Reflecting the economics of segregation and portability in quantifying the contributions of financial resources to CCPs:** Under the current EU regime, there is an additional hurdle for clients and clearing members to move towards models that are considered most suitable to allow for successful porting. Gross margin models compared to net omnibus model are considered more suitable to enable porting, but at the same time produce higher stress testing results and therefore default fund contributions by a clearing

member who evaluates between offering these two different types of client access. This additional hurdle should be addressed by reflecting the economics of segregation and porting when calculating stress exposures and default fund contributions. This could be achieved by allowing for stress testing to be amortized by a portability score representing porting likelihood. This would result in mitigating the default fund increase between a net omnibus and a gross-margined model, allowing clearing members to offer affordable solutions for smaller clients to access porting. Addressing the implications for default fund contributions combined with a temporary relief on capital, KYC, and AML-requirements for clearing members during porting (and several months thereafter) would remove one of the main hurdles that currently prevents clearing member adoption of more suitable models for client clearing.

Please refer to our comments to the questionnaire for further details.

## B) Detailed comments to the questionnaire

### Access

#### Design of direct and sponsored access models

1. Do you agree with the observation in the discussion paper that the direct and sponsored access models are designed for and generally used more by larger and/or more sophisticated clients?

Direct and sponsored access models are at an embryonic stage in terms of development, implementation and market adoption. They are designed to address specific risk management and resource management (capital, funding and liquidity, and economic returns) challenges faced by general clearing members, in respect of traditional client clearing. The fact that the target audience for these models are larger and/or more sophisticated clients is a natural consequence of the risk management and resource management objectives of clearing members. The models also provide substantial benefits for those clients that choose to adopt them, in particular, counterparty risk reduction, increased margin collateral choice, improved asset protection and access to enhanced cash and collateral management services (repo).

While the models have not primarily been developed specifically to address broader public policy issues (i.e. access to clearing, concentration risks etc.), the adoption of these models will reduce the cost of capital for the provision of clearing services which, subsequently, may lead to more banks offering clearing services and thereby reduce clearing broker concentration.

Nevertheless, the question remains if banks are capital constraint respectively offering traditional client clearing is economically not very attractive, why a broader adoption of such models is not materializing despite the proven economic and capital benefits.

2. Could there be any other solutions that would facilitate access, either through greater use of such access models by small and medium-sized clients, or through some other solution?

Eurex Clearing would like to clarify that sponsored access models are available as well for small-to-medium sized clients, and offer a promising new avenue to support clearing accessibility. Referring to our answer to the previous question, large clients with significant directional exposures are potentially more concerned of counterparty credit, porting, asset protection than smaller players, therefore it appears natural that large or more sophisticated market participants are first adopters. While Eurex Clearing welcomes discussion and debate on clearing accessibility, policymakers should be cautious in advocating broader access to clearing if it is to the detriment of the economic viability and operational resiliency of central counterparties and their clearing members / sponsors.

Notwithstanding the above, there is much more scope for innovation in how to optimize credit, market, operational, legal and funding / liquidity risk management constraints that impede innovation in the development of new models for central clearing. As an example, direct access and sponsored access models could be further enhanced and the utility improved if third parties are able to directly cover the day-to-day funding of margin requirements of direct access participants, thereby reducing the liquidity, legal and operational burdens of meeting CCP margin requirements.

In 2019, the Federal Reserve Bank of Chicago released a working paper on direct access to clearing which covered many of the issues discussed in the IOSCO consultation paper. The

paper proposed the idea that small and medium-sized clients should form a cooperative legal structure and use the economies of scale to overcome the constraints presented by traditional client clearing. While there would be some potential conflicts with current established standards for CCP membership criteria, the idea is worth investigating.

## Barriers

3. Do you agree with the findings in the discussion paper that direct and sponsored access models are used more for certain types of products (eg repos) than for others? Do you agree with the reasons described in the paper for why this is the case? Why/why not?

We do agree that direct access and sponsored access models are more used for repo products. This relates to our response to question 1, that these models have been designed to address specific risk management and resource constraints faced by clearing members.

As a product, repo is more constrained by the Leverage Ratio than Risk Weighted Assets. Under the Leverage Ratio, repos are highly capital intensive as the leverage exposure is based on accounting standards which treat these transactions on a gross basis. Balance sheet netting is only permitted under very limited circumstances. CCPs are uniquely placed to enhance opportunities for balance sheet netting, and direct/sponsored clearing models can reduce the leverage exposure for matched book repo portfolios to de-minimis levels.

While repo has been the most successful use case for direct access and sponsored access clearing models, these models also offer significant benefits for other asset classes such as over-the-counter derivatives and exchange-traded derivatives. We envisage substantial benefits for clearing members and clients from extension to these asset classes. A combination of market funding and liquidity constraints, operational inefficiencies, the implementation of uncleared margin rules and the final Basel III accords will improve the business case for extending direct access and sponsored access to over-the-counter derivatives and exchange-traded derivatives.

We reiterate that direct access and sponsored access clearing models are not specifically targeted to the public policy objectives of improving access for small and medium-sized clients.

## Challenges related to direct and sponsored access models

4. Do you agree that direct and sponsored access models have the potential to diversify the risk profile of the direct clearing participant basis of a CCP by introducing new types of direct participants? Why/why not?

The decline in the number of general clearing members of CCPs willing to offer client clearing services can be attributed to a number of factors, including: i) general industry consolidation; ii) post-crisis regulatory reform which demand higher capital and liquidity requirements and associated returns from these activities; and iii) more recently, failed risk management at prime brokers, leading to higher level strategic changes. The decline in the number of general clearing members of CCPs has led to broader discussions about the systemic risk impacts of clearing member concentrations and economics of access to clearing by clients.

The attraction of direct access models to date has been driven by the risk management and operational benefits to the client, and economic benefits to the general clearing member that continues to act as a clearing agent for the client. Notwithstanding, direct access models can

diversify and substantially improve the risk profile of the CCP, and the current models are an important first step in achieving these goals.

In the current direct access and sponsored access models, there are limitations to how much improvement in the risk profile can be realized given that general clearing members still carry the financial and operational requirements of the default management process (e.g. bidding obligations in the auctions) and default fund contributions associated with direct access participants. In the future, these models may evolve to direct and sponsored members carrying more of these responsibilities, almost to the point of full direct membership. We therefore believe that a broader adoption of full direct membership could result in further improvements. In this regard, the barriers (e.g. statutory or regulatory restrictions on loss-sharing arrangements etc.) to clients taking on more of those obligations should be reviewed for potential solutions.

In this context, we would also like to point out that economic incentives may also help move to more direct participation in central clearing. CRE 54.14 - 54.17 of the Basel consolidated framework offers preferential risk weights to cleared transactions of banks who are clients of clearing members of a qualifying CCP, subject to a range of conditions commonly referred to as the "look-through criteria." It should be noted that this preferential treatment may indirectly disincentivize banks (clearing as clients) to adopt direct access models, and may need to be revisited depending on the prevailing policy objectives.

Direct access can potentially result in an increase in available resources at the CCP level as previously uncleared products are moved to the CCP which supports a client's liquidity management (e.g. repo) or as Direct Access clients move from Omnibus to an ISA segregation.

5. Do you think that CCPs have introduced sufficient safeguards to prevent risk transmission from direct participants using direct and sponsored access models? Why/why not? If not, what additional safeguards do you think are necessary?

For Eurex Clearing, we have introduced specific safeguards when developing our access models ISA Direct and ISA Direct Indemnified. Both access models (including the safeguards) have been discussed with Eurex Clearing's clearing community and were accepted as being sufficient. Fundamentally, the risks generated by direct access are identical to those arising from a standard clearing membership.

Therefore, Eurex Clearing developed its access models with the same high risk management standard as for other clearing members. In particular, the same risk management requirements applicable to Clearing Members are equally applicable to the ISA Direct Clearing Member and ISA Direct Indemnified Clearing Member. The calculation of the applicable margin requirement and contribution requirement (reg. Eurex Clearing's Default Fund) follow the same rules and methodologies. Important to note is the involvement of the clearing agent acting as the sponsor of the relevant client/direct access member:

- Firstly, the clearing agent takes over the obligation to provide the contributions to the Default Fund for the client.
- Secondly, the clearing agent takes over the obligation to participate in the default management process.
- Thirdly, the clearing agent ensures in the majority of cases also the daily settlement of payment and delivery obligations on behalf of the sponsored client.



In addition, Eurex Clearing implemented further safeguards for the clearing community with respect to any potential risks arising from its direct and sponsored access models catering for the default of a direct access member, providing a further protection of the contributions of the non-defaulting clearing members:

- Under ISA Direct, the assessment calls (additional default fund contributions) are also provided by the clearing agent.
- Under ISA Direct Indemnified, the assessment calls are replaced by an unlimited guarantee by the clearing agent. Such guarantee is enforced by Eurex Clearing immediately after the pre-funded contribution to the default fund are completely realized.

Furthermore, the onboarding process, resources and credit assessment were aligned so that in practice there is no different treatment of clearing members and clients; treatment during assessment calls differs as alluded to in the paper and outlined above.

For entities with higher credit risk, we are enforcing a full indemnity/guarantee by the sponsor to mitigate any potential risk (in relation to ISA Direct Indemnified).

6. Do you think that sponsors are properly incentivised to closely monitor the activity of their sponsored participants (ie the direct participants)? Why/why not? If not, how do you think sponsors could be properly incentivised?

Yes, and we believe that there is a responsibility shared between the client, the clearing agent and the CCP, and incentives across the three must be balanced. The clearing agent has a natural business incentive to fulfill its obligation toward its client, which is reinforced by the obligation to provide the contribution to the default fund for the client, as well as the additional assessment calls / payment obligations under the guarantee to be made by the clearing agent in case of the default of the client.

Further, Eurex Clearing's experience with development of sponsored access models in collaboration with a community of current and potential sponsors indicates that sponsors have no desire to relax the stringent risk management standards for limits and monitoring that they would otherwise apply to bilateral OTC trading and/or client clearing for these same clients. During the development of sponsored access models, the community of sponsors have requested in-depth reviews of process flows and have requested numerous changes and additional controls to facilitate robust risk management of exposures to participants. Sponsors go through rigorous new product approval processes within their organization to ensure that all the required controls are available, and effective enough to reduce residual risks to de-minimis levels.

7. Do you think that the number of sponsors is limited? Are you concerned about sponsor concentration risk? If so, is this because it is difficult to find a sponsor? Are there any other reasons?

Direct and sponsored access models are at an embryonic stage in terms of development, implementation and market adoption. The number of agents and sponsors available is reflective of the stage of market development rather than the nature of the clearing models per se. Accordingly, we have no concerns about sponsor concentration risk over and above the general industry concerns of clearing member concentration risks.

The challenges around the adoption of direct and sponsored access models have more to do with the prevailing market structure around client clearing and the economic incentives to switch, rather than the availability of agents and sponsors. An example is the existing exemption from the clearing mandate for European pension funds. Pension funds are the archetypal direct access clearing participant, given: i) their directional portfolios, ii) demands for operational and process efficiencies, iii) limited appetite for direct exposure to general clearing members, and iv) desire for efficient porting capability in the event of a clearing member default. We expect to see more uptake of direct access clearing from Pension Funds in Europe upon expiry of the exemption from the clearing mandate. Given the competitive landscape for clearing there should be no shortage of clearing agents willing to cover those Pension Funds.

In respect of sponsors for sponsored clearing models (as opposed to agents who are not required to provide indemnities to the CCP in the event of the default of the sponsored member), sponsored clearing models are typically targeted to more leveraged clients such as Hedge Funds. As such clients are highly prized for their profitability, and given the competitive landscape for clearing, there should similarly be no shortage of general clearing members willing to sponsor them.

8. Do you think that CCP rules adequately address the issue of sponsor default? If so, what are the CCP rules that adequately address this issue? If not, what kind of CCP rules are required to address this issue?

Following a Sponsor default, the client has three options:

- i. Upgrade to a standard clearing membership: usually difficult as many direct access members have legal impediments to provide default fund,
- ii. Find a replacement sponsor: in case the client was providing variation margins itself, the connectivity can be maintained for very long, allowing for very good chances of porting. However, if the sponsor was providing the payments, porting might be more challenging, in particular due to the limited number of potential agents. When the model matures, this risk will mitigate itself by increasing the number of alternatives.
- iii. Liquidation: following the same liquidation process as any client or clearing member.

In summary, a sponsor default is managed adequately, as it is, in a worse-case scenario, equivalent to the default of a Clearing Member.

## Testing

9. Have you participated in default management exercises that test direct and sponsored access models?

Yes, Eurex Clearing has run a fire drill before the implementation of the ISA Direct Indemnified model with focus on the default of the indemnified clearing member. In addition, Eurex Clearing conducts regularly porting simulations. In 2021, the porting of an ISA Direct clearing member was tested.

10. Without providing identifying information, what has worked well in such exercises? What has not? Do you have recommendations as to what could be improved for such exercises?

The liquidation went well, all invited members participated. The exercise proved the robustness of the Default Management Process and raised awareness on the indemnifying topic on member's trading desk level. The porting exercise raised awareness of challenges

in regards of porting client positions under different access models. In this context, please also refer to our answers to questions 28 and 31 regarding the possibility to include porting exercises within the EMIR fire drill framework.

#### Additional considerations

11. Please describe any additional factors that may be impacting the activity and uptake of direct and sponsored models that are not considered in this paper.

From Eurex Clearing's perspective, the use of access models could be improved by considering the following points:

- 1) Improved understanding by market participants of legal requirements, the set-up and operational processes.
- 2) European insurance regulators have taken welcomed steps to ensure that the Solvency II treatment for client clearing, where insurers are clients, is in line with and no worse off than the treatment of banks as clients in bank capital regulation. However, insurance regulators did not envisage the situation of insurers becoming direct members of a CCP through direct access models, and accordingly there is a gap in the regulation. We have instances of insurance firms not willing to pursue direct access clearing models because of the regulatory omission, leading to the perverse situation that the insurance firm is economically better off under traditional client clearing compared with direct access models.
- 3) Enhanced understanding of differences in regulatory requirements within and between jurisdictions; there are entities, such as some fund managers (UCITS, AIFMs), which are highly regulated through distinctive legal frameworks in the EU.
- 4) Onboarding process to access models CCPs cannot rely on the existing regulatory standards for these entities but need to apply multiple onboarding requirements, e.g. whilst regulated fund types, e.g. UCITS already provide extensive KYC documentation to their depositaries on a mandatory basis, CCPs cannot lean on this documentation to reduce the on-boarding burden for its clients.
- 5) Some market participants have raised questions on whether the Leverage Ratio treatment of unfunded contributions to the default fund has been adequately addressed in capital regulation in a way that is in line public policy objectives to promote central clearing. As unfunded contributions are a contingent liability, albeit highly remote, there is an interpretation that may fall under off-balance items, which then raises the question as to what credit conversion factor (CCF) should be applied. In relation to RWAs, the European regulation is clear that zero RWAs should be held for unfunded contributions. If policymakers wish to remove any unreasonable barriers to the adoption of direct access models, the Leverage Ratio treatment should be equally explicit that unfunded contributions should not contribute to exposure under the measure. This is particularly important in light of the impending Basel III finalization regulation which raises the minimum CCF applicable for off-balance sheet items from 0% to 10%. Our modelling shows that any capital charges for unfunded contributions under the Leverage Ratio can materially impact the economics of direct access models, and the business case for adoption.

Please also refer to our answer to question 4 regarding further improvements that could be achieved by addressing the barriers for clients taking on more responsibilities from the

clearing members in the default management process, and by assessing economic incentives in relation to preferential treatments under the Basel framework.

12. Please provide any additional comments with regards to the impact that direct and sponsored access models have on access to client clearing.

Eurex Clearing has invested heavily in direct and sponsored access as we expect them to have a positive impact on the clearing landscape because they provide an alternative to traditional client clearing with mutual economic, risk management and operational benefits for agents, sponsors and participants as well as for Eurex Clearing. Eurex Clearing expects direct access and sponsored access clearing models to co-exist alongside traditional client clearing, and the rate of adoption will depend on individual asset classes and/or the evolution of the models. Direct and sponsored access models create capacity and free-up resources of general clearing members, which can only be beneficial for the public policy objectives of improving access to clearing.

As mentioned in our response to question 4, we would also like to reflect the clients' economic dimension. CRE 54.14 - 54.17 of the Basel consolidated framework offers preferential risk weights to cleared transactions of banks who are clients of clearing members of a qualifying CCP, subject to a range of conditions commonly referred to as the "look-through criteria." It should be noted that this preferential treatment may indirectly disincentivize banks (clearing as clients) to adopt direct access models, and may need to be revisited depending on the prevailing policy objectives.

Any measures to incentivize transition from traditional client clearing to direct access models should be carefully evaluated to ensure that there are no unintended detrimental impacts to the profitability or the client portfolio risk profile of general clearing members offering traditional client clearing services. Migration of larger, profitable, lower risk clients to direct access models, while leaving smaller, less profitable higher risk clients on traditional client clearing may lead to more general clearing members exiting the client clearing business and may even lead to systemic risk issues.

13. Please provide additional comments with regard to access to client clearing more generally.

Eurex Clearing would like to reiterate the comments provided to the previous questions in relation to suggestions how access to client clearing could be improved and how greater use of access models could be incentivized.

Generally, we would also like to highlight again that the use of access models should be enabled to the extent possible depending on the risk profile of market participants. However, the demand for access models is a consequence of the risk and resource management of market participants, e.g. with regard to some less sophisticated or smaller clients capacities/resources to invest may be lower or there may be no use case – hence no demand – for them.

## Porting

### Risks from not porting

14. Are there any additional risks or potential harm associated with not porting following a clearing participant default, which were not described in the discussion paper? If so, please describe such additional risks and/or harm.

Eurex Clearing agrees with the identified risks in the discussion paper. On the other hand, it may be worth noting that all of the above may be distressed by the waiting time added by porting, advocating for the possibility of acting swiftly when portability likelihood is close to null.

Please also refer to our answers to the next question in relation to capital, KYC- and AML-requirements as well to question 21 regarding the implications of client consent.

15. Potentially effective practices. Do you agree with the two tools identified in the discussion paper as potentially successful porting practices? Are there any other tools that should be identified as potentially effective practices?

While Eurex Clearing generally agrees with the tools identified in the discussion paper, we would like to pick up the standard setters' finding that regulatory frameworks for porting differ across jurisdictions. Many of the tools or practices described in the discussion paper are therefore not applicable for Eurex Clearing operating under the EU regime (please also refer to our answers to questions 16 and 17 on the applicability of game plans and pre-emptive identification of back-up CCSPs). Strict client consent or KYC requirements for example currently prevent successful porting arrangements for market participants in a given timeframe. If authorities aim at ensuring that porting shall work for every client or at defining those market participants for which successful porting should be ensured, regulatory changes in some jurisdictions are necessary.

Regarding other tools that may qualify as effective practices regulators could consider allowing for the possibility to waive KYC and AML requirements in the porting phase for a defined period of time. As alluded to in the paper, KYC due diligence requirements may prevent swift processes to find back-up CCSPs. This is one of the reasons why CCSPs would only take on clients for porting in case of a default where they have already an established relationship with those clients. Moreover, a standing relationship with a client does not necessarily mean that the backup CCSP takes the additional business from the client in case of the original CCSP's default – this may rather depend on the back-up CCSP's risk appetite for new business at that point in time. In addition to KYC and AML waivers also capital requirement temporary waivers would definitely increase the porting likelihood especially for big directional books as this would ease the efforts on the replacement clearing members' side to take up new clients and/or new business from existing clients.

Further, it could be considered allowing for the possibility to waive the regulatory provision to enable porting for every client. Some clients could be economically better off through liquidation than through porting – in particular for many firms active in the ETD business, where positions are often kept for a short period of time only. Both from the perspective of the client interest, as well as from a perspective of market stability, the importance of fostering porting varies widely from one client to another. Similarly, investment and maintenance cost the client will be required to bear to ensure porting likelihood differs, depending on its current account set-up. We describe below two examples to highlight such differences, and the implications for the stakeholders.

On one hand, a large pension fund keeps its positions for a long period of time (sometimes decades), and usually is set up under an Individually Segregated Account with multiple clearing members, due to the large balance sheet impact of such positions and other regulatory and fiduciary requirements. In order to ensure high porting likelihood, such entity only needs to ensure sufficient risk buffer with its various clearing members and work

adequate internal processes. While this does not come for free, it remains affordable. Comparatively, a failure to port would be dramatic for such pension funds, as it relies on its positions to provide their due income to our elderly. It goes without saying that the consequences for the real economy could be dramatic should the lost portfolio be sizeable. In such conditions, the CCP, and all other stakeholders, should strive toward supporting the best possible porting process.

On the other hand, a small speculative hedge fund, playing short term market move for profitability, will usually be under a net omnibus set-up with a single clearing member, in an attempt to limit its clearing costs. To ensure porting likelihood for such client, it would need to change its clearing model toward gross omnibus or individual segregation and maintain additional clearing relationships with empty accounts (at the back-up clearing members). Such upgrade would come at unreasonable costs for the client, due to gross margining, gross stress testing and maintenance of accounts to alternative CCSP(s). Arguably, such hedge fund may not be as relevant for the overall market stability and real economy on the short term. Finally, such client, should its clearing member still be alive, would have liquidated its positions itself in a market turmoil. Providing long porting period to such customer would come at a risk for the CCP, and would require proportional margin period of risk, leading to a further increased cost, with little to no added benefit, for either the customer, the CCP, or the public.

While there is a large spectrum of clients in between these two extremes, it becomes clear that, unless EU regulation would converge toward the US model significantly in relation to client consent provisions, there should be differentiated porting periods and frameworks for different business segments, clearing models and client types. One model should focus on improving porting likelihood to the largest extent, while the alternative should facilitate orderly and cost-efficient liquidation, minimizing the overarching systemic risk.

In addition, we would like to recommend reflecting the economics of segregation and portability for clients and clearing members when calculating stress exposures and default fund contributions. In the EU legal framework, models that are considered most suitable for porting (gross margin models) may produce higher stress testing results and therefore default fund contributions. Reducing the cost discrepancy between a “portable” client set-up and an “unportable” set-up (net omnibus models) is a necessity to foster porting on a large scale. This could be achieved by aligning the risk management standard to the risk effectively brought by the client to the system, i.e. including its portability into the models. At equal market risk, a client with high probability of porting is not burdening the market stability in the same way a client that will be certainly liquidated does. Regulation could, for instance, allow for stress testing to be amortized by a portability score representing porting likelihood. This would result in mitigating the default fund increase between a net omnibus and a gross-margined model, allowing clearing members to offer affordable solutions for smaller clients to access porting. Generally, the regulation should allow for porting probability to be accounted for in risk models, as porting is a critical component of the default management process.

Addressing the implications for default fund contributions combined with a temporary relief on capital, KYC and AML-requirements for clearing members during porting would remove one of the main hurdles that currently prevents clearing member adoption of more suitable models for client clearing.

16. What additional approaches do CCPs use to pre-emptively identify a backup CCSP? What incentives can be provided to assist the development of alternative/backup CCSP relationships? Are there any other considerations for alternate/backup CCSPs not set forth in the report?

Eurex Clearing offers clients the possibility to flag their back-up CCSPs, however, the majority of clients does not make use of this tool. The sophisticated or large market participants usually have already established relationships to multiple CCSPs due to Business-as-Usual or other reasons, and such established relationships to CCSPs can be used as back-up, while for smaller or less sophisticated market participants the cost-benefits ratio of investing in ensuring porting arrangements, including back-up CCSPs, as well as of the porting process itself may imply little demand.

Please also see our answers to questions 15 and 27 for potential solutions through temporary waivers of capital, KYC and AML requirements and review of client consent provisions.

17. Are there other considerations for having a game plan that were not described in the discussion paper?

For a "Game Plan" to have decent chances of success, the CCP would need to anticipate the decision of various stakeholders, in particular clearing members and clients. In a regulatory environment like the EU regime where client consent is explicitly required, such game plan has low chances of success and, thus, is currently not applicable for Eurex Clearing.

18. In addition to those outlined in the paper, what attributes of account structures facilitate or impede porting client accounts?

As per our answer to the next question, gross margined account structures make it easiest for porting to happen as positions and collateral can be easily determined. As identified in the paper, undisclosed net omnibus accounts paired with client consent represent the biggest hurdle for successful porting. The ability of directly fulfilling payments substantially influence portability as it allows for an extended decision period without increasing risk for the CCP and the rest of the clearing community.

19. Are some client accounts not suitable for porting?

As pointed out in our answers to the previous , Eurex Clearing would consider gross margined and individually segregated account structures most suitable for porting. However, net omnibus segregated accounts, where several clients have to consent on the same replacement CCSP, are particularly challenging to port. Moreover, the undisclosed nature of net omnibus accounts represents an extra hurdle for the alternate CCSP's onboarding. These difficulties can be overcome under a regime where the authorities are driving the porting exercise. Under such framework, client consent would be waved, removing the requirement of reaching an agreement between all clients, and authorities would have access to the list of clients on the account, which they could share the relevant stakeholders (e.g., potential replacement clearing member). Please refer to our answer to question 21 for further details.

In a regulatory framework where the responsibility lies with the client, segregation is a necessary condition to allow for a successful porting, but this condition is not sufficient. Net margined accounts are nearly guaranteed to fail porting, but not all gross-margined account have the same chances to succeed, as having alternative/back-up CCSPs as well as the degree of operational preparedness are also key components of a successful porting. Please

refer to our answer in question 15 to see a detail explanation of the influence of models and client types on the porting chances.

Set-ups in which end users indirectly clear via an affiliate of the clearing member acting as disclosed client renders porting in-effective due to interdependencies between the disclosed client and the defaulted member.

Eurex Clearing is flexible to support several solutions, including elaborate position and collateral segregation as well as supporting the segregation for every clearing model.

ISA and GOSA models already increase the likelihood of porting compared to NOSA accounts. As explained under the access model section above, building on the ISA segregation, we offer clients direct access models to clear OTC IRS and repos (which could easily be expanded to cover ETD, if demand was arising), increasing safety and robustness through reduced concentration and improved portability. Clearing members using our ISA Direct and ISA Direct Indemnified models, when operationally set-up respectively, can have a longer porting period should its clearing agent default.

We would like to re-iterate, as mentioned in our answer to question 15, that client set-ups that enable porting are expensive for the end users, basically putting good behavior at a disadvantage. For an increased likelihood of porting on a large scale, the cost difference between these set-ups should be reduced.

20. Does holding excess collateral and the ability to make direct payments improve the probability that a client will be ported successfully or are there impediments to using this collateral?

Yes, holding excess collateral and direct payments helps for Individually Segregated Accounts to cover for any losses before finding a replacement CCSP and porting becomes necessary. This can buy time that is critical to the success of porting, as the CCP would only be comfortable with extending porting period when over-collateralization or re-collateralization during the porting period guarantees the positions, avoiding to burden the clearing community with additional risks. Direct payments, however, may mostly work for more sophisticated clients having sufficient resources/capacities to invest in such arrangements. In any case, experience has shown that direct payments cannot be improvised on short notice once they are required. They should therefore be implemented in the beginning (or as a fallback) when a client establishes a relationship with a clearing member and tested regularly. In a nutshell, direct payment is an extremely useful tool to make porting possible, but it necessitates that technical and legal infrastructure are already in place prior to the default event for each affected client.. Legal set-up is easier to implement for direct access models than typical client clearing models, due to the existing relationship between the CCP and the porting entity.

21. What is your view of a client consent mechanism that could be used to facilitate porting, if permitted under applicable law?

From Eurex Clearing's perspective, this question is not the relevant question in this regard.

Under European law, porting is only foreseen as an option and depends on what the relevant client actually wants. Pursuant to the clearing models offered by Eurex Clearing, the relevant client needs to inform Eurex Clearing, whether it wants to be ported or closed out. Thus, the porting process is eventually initiated by the client.



Under US law, the LSOC-rules foresee that porting is organized by the regulators and the insolvency administrator of the defaulting clearing member and executed by the CCP in cooperation with the potential replacement clearing member.

Thus, a solution for facilitating the porting process could be implemented under EU law (i.e. EMIR) allowing for the same technique as foreseen under the LSOC-Rules. A rule could be implemented stating that the entire porting process shall be coordinated by the CCP in cooperation with the replacement clearing member. This would cover the transfer of the client-related transactions from the defaulted clearing member to the replacement clearing member without the involvement of the defaulting clearing member and the relevant clients. In addition, this would also include the establishment of a “statutory” client relationship between the replacement clearing member and the relevant client. If the client afterwards does not want to clear its transactions via the new clearing member, the client and such new clearing member can agree on a termination and settle the clearing relationship between themselves without the involvement of the CCP.

Such procedure would speed up the porting process and would also facilitate the liquidation process for the CCP. Additionally, the market pressure arising from the fact to enter into replacement transaction would be reduced for the CCP leading for more competitive prices for replacement transactions.

22. Are the potentially effective practices described in the discussion paper consistent with prior porting experiences?

No comment.

23. Are there any barriers to implementing potentially effective porting practices that are not described in the discussion paper?

There are ways to increase the likelihood of successfully porting clients and avoiding market impact following a CM default. As alluded to in our answers to the previous questions, Eurex Clearing would consider the following elements as relevant barriers impeding effective porting:

- One of the crucial factors is for clients as well as potential replacement CCSPs to be prepared, i.e. familiar with porting processes and requirements.
- Another factor is the cost for clients of maintaining multiple relationships to clearing members to ensure a back-up clearer for the porting phase as clearing members only tend to accept clients in case of a default to which they have already established a relationship (see our answer to question 16). This is closely linked to current regulatory requirements such as KYC due diligence provisions which render a swift process of accepting clients in case of a default impossible. Although CCPs may request that clients appoint back-up CCSPs and porting could be considered a straightforward process, in practice, some challenges remain. For example, as outlined in our answer to question 15, a standing relationship with a client does not necessarily mean that the backup CCSP takes the additional business from the client in case of the original CCSP's default – this may rather depend on the back-up CCSP's risk appetite for new business at that point in time. Further, the back-up CCSP could face financial or operational resource capacity limits preventing them from taking up (new) clients, or CCSPs could be reluctant to take on clients' accounts

where this could trigger additional capital requirements. In this context, in the current status the porting period would be barely enough for onboarding and operational procedures assuming that alternate CCSPs contracts would be already in place. Allowing for temporary waivers of KYC, AML, capital requirement for clearing members and CCPs would remove major hurdles and increase the likelihood of porting also for clients without alternate CCSPs (please refer to our answer to question 15).

- There are also challenges depending on the type of client account that needs to be ported (see questions 15 and 19). Unless regulatory requirements would allow authorities to coordinate the porting process, a solution to address those challenges could be to consider different porting conditions to different client types and account structures, fostering porting for those with adequate set-up, and ensuring optimal orderly liquidation in case porting fails for the others.
- Most importantly, as explained in our answer to question 21 and alluded to in the discussion paper, another possibility to facilitate porting could be to change the porting process to a process that is organized by regulators and the insolvency administrator of the defaulting clearing member and executed by the CCP in cooperation with the replacement clearing member. This would require a review of client consent provisions in some local regimes.

#### Communication and coordination

24. Are there any additional communications by the CCP or the defaulting CCSP that may increase the probability of porting client accounts?

At Eurex Clearing, we ensure emergency communication with clearing members and clients in case of a defaulting CCSP and we publish relevant information for the public on our website.

Importantly, a certain level of transparency should be ensured about which steps are to be taken by CCPs, clients and clearing members in case of a CCSP default. A detailed description of the porting process and necessary requirements has always been available on Eurex Clearing's website. Clients and clearing members are invited to participate in porting exercises to test these procedures in case they want to be prepared.

As Eurex Clearing is also offering direct access models, we would also like to point out that we inform all members that there is a default taking place.

25. Are there additional actions CCPs can take following a clearing participant default to coordinate that are not set forth in the discussion paper? Are there any limitations on coordination that are not included in the paper?

Please refer to our answer to the previous question.

#### Harmonisation

26. Are there additional items CCPs can harmonise or standardise during business as usual that are not outlined in the discussion paper? Are there any factors that may impede harmonisation or standardisation that are not provided in the paper?

Harmonization of porting procedure can only be done within harmonized regulatory environment and Default Management Procedure (DMP). The porting process is integrated

within the DMP, and in particular is accounted for in the Margin Period of Risk (“MPOR”). Different MPOR often implies different porting procedures or reciprocally. We would therefore like to clarify in general that harmonization has natural limitations. As long as there are different regulatory regimes in different jurisdictions, different time zones, different products, market structures and client types etc., there will always be differences in porting mechanisms. One may also argue that harmonization of practices without a regulatory harmonization would be detrimental.

#### Notable issues to consider when developing a porting protocol

27. Are there additional regulatory requirements that could impede porting? Can such impediments be addressed or mitigated through action prior to the CCSP’s default?

As mentioned in our response to question 15, we would like to pick up the standard setters’ finding that regulatory frameworks for porting differ across jurisdictions. Many of the tools or practices described in the discussion paper are therefore not applicable for Eurex Clearing operating under the EU regime. Strict client consent or KYC requirements for example currently are significant hurdles for successful porting arrangements for market participants. If authorities aim at ensuring that porting shall work for every client or at defining those market participants for which successful porting should be ensured, regulatory changes in some jurisdictions will be necessary.

Regarding other tools that may qualify as effective practices regulators need to consider allowing for the possibility to waive KYC- and AML-requirements in the porting phase for a defined period of time. As alluded to in the paper, KYC due diligence requirements may prevent swift processes to find back-up CCSPs. Usually, CCSPs only take on clients for porting in case of a default where they have already an established relationship with those clients. Further, it could be considered allowing for the possibility to waive the provision to enable porting for every client. Some clients could be economically better off through liquidation than through porting – in particular for net omnibus accounts.

US CCPs have experienced multiple defaults of members offering client clearing services and porting, other regulatory regimes should inspire themselves from those successful experiences.

28. Are there any additional factors that should be addressed in testing exercises?

Porting fire drills have an inherited flaw, it is not possible to realistically simulate clearing members’ decisions during peace time.

Participant’s readiness could be improved by further testing, a good platform to do that would be the Default Management fire drill that is executed once per year and coordinated across multiple CCPs, porting should be ideally included in the scope.

Nevertheless, increasing clients and clearing members participation would increase its realism.

29. Please provide examples of good disclosure practices from your perspective.

Communication should not only be targeted to direct clients and potential CCSPs but the whole market where feasible. CCP’s website should be used as a tool to reach and educate the broader market on the topic.

And on that note Eurex Clearing has published on its website all the information about porting procedures, requirements, and timeline. However, during discussion with participants it emerged the fact that clients are not well informed about the topic as porting has low priority for most customers.

30. Are there other arrangements a CCSP can make to ensure that, post default, the CCSP can help coordinate porting at multiple CCPs if the CCSP is a non-defaulter? If the CCSP defaults, what arrangements can the CCSP make to facilitate the porting of its clients?

Please refer to our answers to questions 24 and 29.

### Suggested next steps

31. Please provide feedback on the suggested next steps for consideration. Do you agree that these issues warrant further consideration by CCPs, CCSPs and/or clients? Are there additional issues that may warrant further consideration?

While agreeing that the suggested next steps are worth considering in the future, we noted that CPMI IOSCO has addressed the majority of the recommended next steps to CCPs. Eurex Clearing would like to emphasize that CCPs (as well as clearing members and clients) can only take minor steps themselves to enhance porting procedures within the given regulatory framework. For truly making progress in increasing the likelihood of successful porting, regulatory changes of local regimes will be necessary to address current hurdles and restrictions for both CCPs and clearing members/CCSPs.

In our answers to questions 15, 21, 23 and 31 we have outlined a number of potential measures to address barriers impeding effective porting, increasing the likelihood of successfully porting clients and avoiding market impact following a clearing member default:

- **Fostering awareness and preparedness:** One of the crucial factors is for clients as well as potential replacement CCSPs to be prepared, i.e. to be familiar with porting processes and requirements. We believe that the introduction of porting exercises within the EMIR fire drill framework could be considered to further improve awareness and preparedness by the industry.
- **Relief for clearing members /CCSPs' hurdles and restrictions:** Allowing for temporary waivers of KYC, AML and capital requirement for clearing members and CCPs in the porting phase would therefore remove major hurdles and increase the likelihood of porting also for clients without alternate CCSPs.
- **Review of client consent mechanisms:** Taking inspiration from frameworks that have proven successful in other regulatory regimes, porting could be further streamlined and facilitated if the porting process would be changed to a process that would allow the CCP to execute the porting process without the positive ex-ante consent by the client. Under EU law, porting depends on client consent, while in the US, the LSOC-rules foresee that porting is organized by the regulators and insolvency administrator of the defaulting clearing member while the CCP and the potential replacement clearing member execute. For facilitating the porting process under EU law (i.e. EMIR) the same technique as foreseen under the LSOC-Rules could be implemented, stating that the porting process shall be organized by regulators and the insolvency administrator and executed by the CCP in cooperation with the

replacement clearing member. Such procedure would speed up the porting process and would also facilitate the liquidation process for the CCP.

- Differentiating client types and account structures for a meaningful increase of portability: Unless the insolvency administrator and/or the regulatory authorities are driving the porting process, the probability of porting will significantly differ from one client to another. In this context it is important to consider that there are different types of clients, and, consequently, different degree of sophistication, clearing models, as well as the nature of the business of the client. In order to obtain good porting likelihood, a client would need to be on a gross-margined model, maintain multiple clearing relationships, and develop adequate procedures, all of which come at a cost. Requiring all clients to maintain this degree of sophistication would be detrimental to the ambition of easing access to central clearing to smaller entities. Such costs are likely disproportionate in particular for institutions with low interest in porting. Additionally, granting sufficiently long porting period to accommodate clients with low porting likelihood can only be done at the risk of the broader clearing community, as the market move during the period will be borne by the lines of defense. Considering the EU regulation, increasing porting likelihood for all customers to the same extent might not be the right path. Unless the local regime would converge toward the US model in relation to client consent provisions, there should be differentiated porting periods and frameworks for different business segments, clearing models and client types, fostering porting for those with adequate set-up, and ensuring optimal orderly liquidation in case porting fails for the others.
- Reflecting the economics of segregation and portability in quantifying the contributions of financial resources to CCPs: Under the current EU regime, there is an additional hurdle for clients and clearing members to move towards models that are considered most suitable to allow for successful porting. Gross margin models compared to net omnibus model are considered more suitable to enable porting, but at the same time produce higher stress testing results and therefore default fund contributions. This should be addressed by reflecting the economics of segregation and porting when calculating stress exposures and default fund contributions. Regulation could allow stress testing to be amortized by a portability score representing porting likelihood. This would result in mitigating the default fund increase between a net omnibus and a gross-margined model, allowing clearing members to offer affordable solutions for smaller clients to access porting.

## C) Closing Remarks

Eurex Clearing trusts that our comments are seen as a useful contribution to progress on client clearing, and remain at the disposal of the CPMI and IOSCO for any questions and additional feedback.