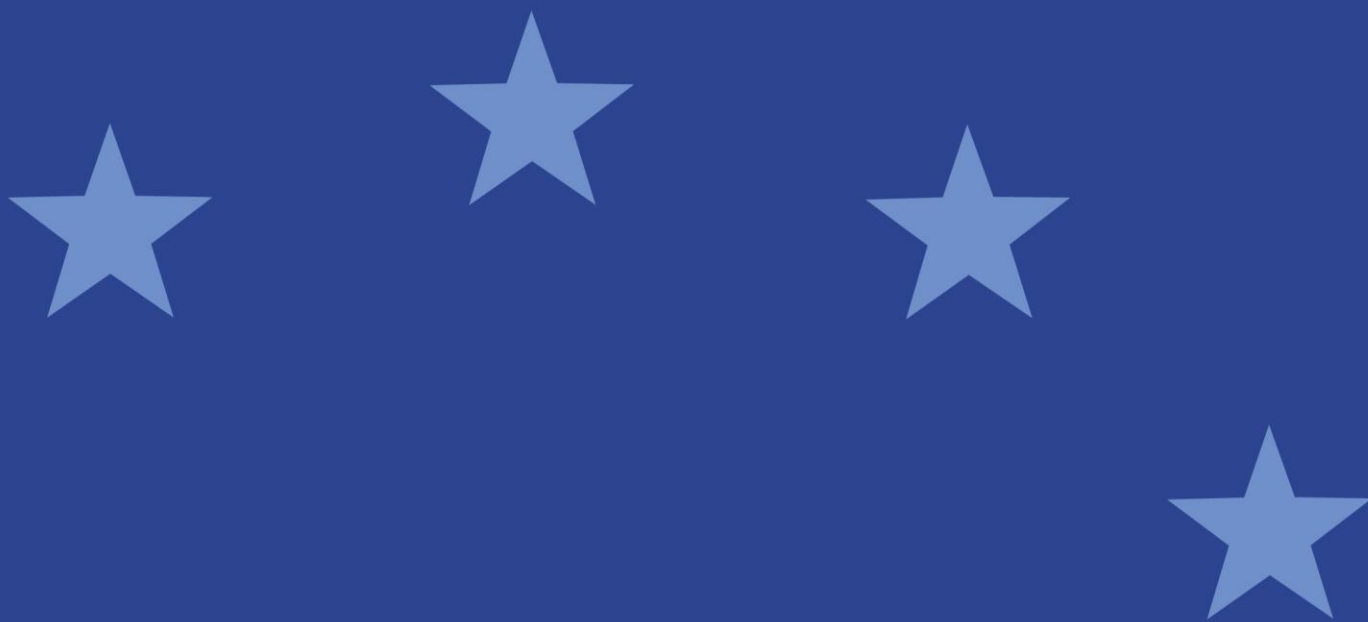




European Securities and  
Markets Authority

# Final Report

Guidelines and Recommendations for establishing consistent, efficient and effective  
assessments of interoperability arrangements



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## Acronyms Used

CCPs	Central Counterparties
CP	Consultation Paper
EMIR	European Market Infrastructures Regulation – Regulation (EU) 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories – also referred to as “the Regulation”.
ESMA	European Securities and Markets Authority
IA	Interoperability Arrangements
NCA	National Competent Authority
RTS	Regulatory Technical Standards

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## **I. Executive Summary**

### **Reasons for publication**

This paper contains Guidelines and Recommendations as mandated under Article 54(4) of EMIR which requires ESMA to develop Guidelines and Recommendations with a view to establishing consistent, efficient and effective assessments of interoperability arrangements.

Guidelines and Recommendations set out ESMA's view of how Union law should be applied in a particular area, or of appropriate supervisory practices within the European System of Financial Supervision. ESMA expects all relevant national competent authorities (NCAs) to comply with these Guidelines and Recommendations.

### **Contents**

This final report discusses feedback received from ESMA's December 2012 consultation and subsequent changes to the draft Guidelines and Recommendations made by ESMA. For each section, a reference is made to the relevant Article in EMIR.

### **Next steps**

These Guidelines and Recommendations will become effective one month after their publication by ESMA on its website in the EU official languages.

NCAs should comply with the Guidelines and Recommendations by incorporating them into their supervisory practices. NCAs must notify ESMA whether they comply or intend to comply with these Guidelines and Recommendations, including with a justification of the reasons for any non-compliance, within two months of publication by ESMA on its website of the final Guidelines and Recommendations in all EU official languages. Financial market participants are not required to report to ESMA whether they comply with these Guidelines and Recommendations.

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## **II. Introduction**

1. Under Article 54(4) of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories (EMIR), ESMA is required to issue by 31 December 2012 Guidelines and Recommendations with a view of establishing consistent and effective assessments of interoperability arrangements.
2. On 19 December 2012 the European Commission adopted without modifications the regulatory technical standards developed by ESMA. These technical standards were published in the Official Journal on 23 February 2013 and enter into force on 15 March 2013.
3. Following the entry into force, CCPs will have 6 months to apply for authorisation under EMIR and NCAs will have 6 months following receipt of a complete application to authorise a CCP.

4. ESMA prioritised, in 2012, the work on the technical standards and therefore only launched its consultation on these Guidelines and Recommendations (and not the final Guidelines and Recommendations) before 31 December 2012. In prioritising work on the technical standards, ESMA considered that the applicability of the Guidelines and Recommendations would not be immediate and that finalising the Guidelines and Recommendations by 31 December 2012 would have required compressing or skipping the consultation period, which would have been undesirable for such a complex, technical and relevant matter. Given that the Guidelines and Recommendations will be used by NCAs during their assessment of applications for CCP authorisations (in the case of pre-existing interoperability arrangements) and for the extension of CCP authorisations (in the case of new interoperability arrangements), ESMA revised the calendar for issuing these Guidelines and Recommendations, undertaking to issue them in final form ahead of the assessment period by NCAs.
5. The objective of these Guidelines and Recommendations is to improve the rigor and uniformity of standards applied in the assessments of interoperability arrangements. The Guidelines and Recommendations define what NCAs should analyse in assessing an interoperability arrangement and therefore on what aspects of the interoperable arrangement the relevant CCPs will need to focus their attention.
6. It should be noted that these Guidelines and Recommendations do not introduce new requirements for CCPs in addition to the ones specified in EMIR or the relevant technical standards. However, they specify how those requirements should be met for the purpose of establishing robust and stable interoperability arrangements.
7. The Guidelines and Recommendations focus on the risks that might arise from interoperability arrangements and outline the areas on which CCPs should focus, and which NCAs should verify, to mitigate those risks. The Guidelines and Recommendations are set out at Annex III.
8. Concerning legal risk, NCAs will need to verify that legal risks arising from the interoperability arrangements are appropriately managed and there is a high degree of confidence that the interoperable CCPs have rules and, where required, other legal arrangements that are coherent and enforceable under the interoperability arrangement. For this reason, the arrangement should clearly identify the rights and obligations of the relevant CCPs and the process and procedures to be followed for the proper functioning of the arrangement.
9. The Guidelines and Recommendations on fair and open access have been drafted to ensure that the provisions in Article 51(3) of EMIR are respected and therefore future expansion of the interoperability arrangement to other CCPs is not restricted other than on risk grounds. On the other hand, the interoperability arrangement should also permit its termination on risk grounds.
10. The Guidelines and Recommendations on identification, monitoring and management of risks are critical for ensuring the prudent management of the interoperability arrangement to guarantee the safety of all interoperable CCPs. The main drivers of these Guidelines and Recommendations are: a) ensuring that the interoperability arrangement does not expose the relevant CCPs to additional risks that are not appropriately mitigated; b) to ensure that any risk to which a CCP is exposed, and that can affect the safety of the other interoperable CCPs, or of the arrangement itself, is adequately assessed, monitored and mitigated.
11. The objective of the Guidelines and Recommendations on deposit of collateral is to ensure the timely availability of collateral in all circumstances, including upon the default of an interoperable CCP.

12. Finally, the Guidelines and Recommendations on cooperation between NCAs have been designed to ensure a smooth approval process for interoperability arrangements.
13. ESMA consulted stakeholders from 20 December 2012 to 31 January 2013. A total of thirteen submissions were received by ESMA (a list of respondents is set out at Annex I and the responses have been published on the ESMA website (<http://www.esma.europa.eu/consultation/Consultation-Guidelines-establishing-consistent-efficient-and-effective-assessments-int#responses>)). Responses were submitted by CCPs (5), market infrastructures (3) and trade associations (5).
14. This final report contains a summary of the responses received by ESMA and the rationale for retaining or amending the text of the draft Guidelines and Recommendations following the consultation process.
15. One essential element for the drafting of Guidelines and Recommendations is the analysis of the cost and benefits that the proposed measures might entail. This final report includes an impact assessment in Annex II. Feedback received on ESMA's consultation paper suggested that ESMA's draft cost-benefit analysis was an accurate representation of the likely costs and benefits resulting from ESMA's proposed Guidelines and Recommendations and so the cost-benefit has not changed materially from that presented in ESMA's consultation paper.
16. These Guidelines and Recommendations are issued under Article 16 of the ESMA Regulation. In accordance with Article 16(3) of the ESMA Regulation, NCAs must make every effort to comply with the Guidelines and Recommendations.

### **III. Feedback from stakeholders and changes to the draft Guidelines and Recommendations**

#### **III.I Guideline and Recommendation 1**

##### Legal risk – (a) Documentation

1. Comments on this Guideline and Recommendation centred on one key theme, that being the degree to which the risk committee and clearing members should be consulted on changes to interoperability arrangements/made aware of the content of documentation concerning interoperability arrangements. These issues are considered in turn.
2. Turning first to comments on the degree to which clearing members should be consulted on the establishment of, or changes to, interoperability arrangements. The trade associations supported greater consultation, whereas the CCP respondents generally opposed such consultation. The trade associations did not draw a distinction along the lines of materiality, generally arguing for consultation in respect of all changes.
3. This Guideline and Recommendation requires that there be a process to consult the risk committee and the clearing members where the establishment of, or any change to, the interoperable arrangement is likely to have a material impact on the risks to which a CCP is exposed. Therefore this Guideline and Recommendation already requires consultation of the risk committee and clearing members, albeit subject to a materiality threshold.
4. Turning next to comments on the degree to which clearing members should be informed about the establishment of, or changes to, interoperability arrangements; the trade associations, CCPs and market

infrastructures that commented on this provision all supported transparency of interoperability arrangements (including legal documentation) to clearing members. This Guideline and Recommendation requires that there be a process for informing clearing members where the establishment of, or a change to, an interoperability arrangement might have an impact on the operations of clearing members. With broad support for the draft Guidelines and Recommendations, ESMA has retained these provisions but considers that requiring more general disclosure would not be proportionate to the cost of doing so.

5. One CCP suggested that greater prescription is required in respect of the documentation of the dispute resolution mechanism and the termination of interoperability arrangements. This Guideline and Recommendation does already require that the conditions and procedure for termination of an interoperability arrangement are clearly defined and that the dispute resolution mechanism is clearly indicated. That CCP did however emphasise that the dispute resolution mechanism should be clearly *defined* and in this regard ESMA has amended the terminology in this Guideline and Recommendation from 'indicated' to 'defined'.

#### Legal risk – (b) Legal analysis

6. One CCP submitted that due diligence by CCPs is unnecessary in light of interoperating CCPs being subject to regulatory oversight. While ESMA agrees that due diligence is something that will be undertaken by NCAs or ESMA in the course of the authorisation/recognition of a CCP under EMIR, and such due diligence could be leveraged by a CCP in assessing the CCPs with which it interoperates, ESMA notes that CCPs undertake due diligence on their members even though these are typically regulated entities, and similarly a CCP should always undertake an appropriate amount of due diligence on the CCPs with which it proposes to interoperate. ESMA has, however, amended this Guideline and Recommendation to better specify the objective of the provision, such that a CCP has a high degree of confidence that its rules and procedures and the interoperability arrangement will be enforceable.
7. One CCP requested that the term 'high degree of confidence' be defined. This is a term which is commonly used to describe the degree of due diligence required (for example it is used extensively in the relevant Principle as promulgated by CPSS-IOSCO) and ESMA considers it unnecessary to define it further in this circumstance.
8. One trade association suggested that NCAs should not only check that a CCP has undertaken appropriate legal analysis but should also check the substance of such analysis. While NCAs will necessarily need to review the legal analysis produced by CCPs to ensure that it is appropriate and sufficiently detailed, ESMA considers it inappropriate to expect that NCAs would duplicate legal analysis already undertaken by CCPs (which might, for example, involve obtaining expensive external legal opinions) beyond reasonable checks to ensure that appropriate due diligence has been undertaken.
9. Finally, a general submission was made by one market infrastructure in respect of Question 4 of the consultation paper and which is considered relevant to this Guideline and Recommendation. The submission was that generally interoperability arrangements should be re-assessed on a regular basis by NCAs. ESMA considers that this comment has particular relevance to this Guideline and Recommendation. The legal framework of the jurisdictions in which a CCP and its interoperating CCPs operate are likely to evolve and ESMA considers it would be prudent for NCAs to check that CCPs not only undertake the requisite legal analysis at the time of establishment of an interoperability arrangement but also on a regular basis and has amended this Guideline and Recommendation accordingly.

### III.II Guideline and Recommendation 2

#### Open and fair access

10. The majority of respondents commenting on this Guideline and Recommendation made only general comments. It would also appear that this Guideline and Recommendation enjoys support amongst both the CCP and clearing member communities.
11. One trade association questioned who will determine whether a justification is adequate. ESMA considers that this Guideline and Recommendation is already sufficiently clear that it is the CCP's NCA which will make such a determination. With regards to the parameters that the NCA should use, ESMA has considered whether this Guideline and Recommendation should prescribe further guidance regarding what would constitute adequately substantiated risk grounds for preventing the establishment of, or terminating, an interoperability arrangement and considers that the required level of justification will depend on the CCPs involved and the particularities of the interoperability arrangement itself and ESMA does not consider it appropriate to set out in this Guideline and Recommendation those situations in which risk grounds might be considered to be adequately substantiated. While ESMA recognises the need for harmonisation of decisions across NCAs, ESMA considers that the CCP college process under EMIR will sufficiently ensure such harmonisation rather than increased prescriptiveness in this Guideline and Recommendation which would serve to unnecessarily constrain the flexibility of NCAs.
12. One trade association proposed that a CCP should be required to provide its clearing members with 6 months' notice prior to terminating an interoperability arrangement. While the termination of an interoperability arrangement will have an effect on clearing members, and CCPs should endeavour to provide clearing members with as much notice of such termination as possible (as is required by Guideline and Recommendation 1(a)), ESMA does not consider it appropriate for a minimum notice period to be specified in the Guidelines and Recommendations. This is because termination is required to be on risk grounds which imply that a CCP would be terminating the interoperability arrangement at a time when continuation of the arrangement (even for a short period such as 6 months) might put the safety of the CCP at risk. While ESMA does not consider it appropriate to include a minimum notice period in the Guidelines and Recommendations, this Guideline and Recommendation has been amended to highlight that clearing members should be given as much notice as possible of the termination of an interoperability arrangement.
13. One trade association proposed that a CCP should be required to provide justification for terminating an interoperability arrangement to both its NCA and the NCA of the interoperating CCP. There is, however, unlikely to be a direct relationship between an NCA and an interoperating CCP, instead an NCA is likely to receive information via the NCA of the interoperating CCP. This is reinforced by Guideline and Recommendation 5 which establishes requirements for cooperation between NCAs. On this basis, ESMA considers that a CCP's justification for terminating an interoperability arrangement will be presented to the NCA of the interoperating CCP, albeit via the CCP's own NCA. Against this background, ESMA does not consider it appropriate to further mandate such information sharing in the context of this Guideline and Recommendation.
14. One trade association commented in respect of the applicability of the Guidelines and Recommendations in respect of interoperability for derivative instruments. While interoperability in respect of derivative instruments (including OTC derivative instruments) is permitted under EMIR (the provisions of Title V simply do not apply to such arrangements) it is expected that NCAs will apply ESMA's Guidelines and Recommendations to interoperability arrangements for products other than transferable securities or money-market instruments and expected that CCPs will have regard to the provisions in Title V of EMIR when structuring such interoperability arrangements. However, given the mandate for these Guidelines



and Recommendations comes from Title V of EMIR which pertains only to transferable securities or money-market instruments, ESMA considers it inappropriate to incorporate in these Guidelines and Recommendations requirements that are specific to interoperability arrangements for derivative products.

### **III.III Guideline and Recommendation 3**

#### Identification, monitoring and management of risks – (a) General policies, procedures and systems

15. This Guideline and Recommendation attracted the most comment of any of the Guidelines and Recommendations. Respondents were mainly concerned about the requirement for CCPs to assess the operations of interoperating CCPs, in particular, the requirement for CCPs to assess reliance on service providers. Arguments advanced in respect of this point were:
- The impracticality of such assessment given differences in technology and methodologies.
  - The difficulty of disclosing this type of information given the likelihood of it being commercially sensitive.
  - CCPs should be able to rely on the EMIR authorisation of interoperating CCPs.
  - Overly granular assessment requirements could be abused to frustrate interoperability.
  - CCPs cannot influence interoperating CCP decisions about matters such as service providers.
16. The underlying concern sought to be addressed by this requirement is that CCPs should be identifying, monitoring and managing the potential risks arising from an interoperability arrangement, including those potential risks which stem from the operational structure of an interoperating CCP and any interdependencies between the interoperating CCPs. The relevant requirement (at Guideline and Recommendation 3(a)(ii)) requires that a CCP should have comprehensive information on the operations of interoperating CCPs, including the potential reliance on third parties as critical service providers, enabling the CCP to perform effective periodic assessments of the risks associated with the interoperability arrangement. ESMA has considered the submissions made on this point and agrees with respondents that requiring ‘comprehensive information’ might be difficult without the sharing of commercially sensitive information and could potentially act as a disproportionate barrier to interoperability. ESMA has amended this Guideline and Recommendation accordingly.
17. Another key concern for respondents (CCPs, a market infrastructure and a trade association) was the requirement for a clear process for informing and agreeing changes to the rules of one interoperating CCP (Guideline and Recommendation 3(a)(v)). One CCP supported this requirement, whereas one CCP and one market infrastructure expressed concern. These concerns were that it is disproportionate to require interoperable CCPs to share information on all rule changes, including those that do not affect the interoperable link and that a requirement to agree rule changes would undermine CCP independence and go beyond what is required by EMIR. Instead, dispute resolution arrangements were suggested to be sufficient.
18. ESMA notes that the Guidelines and Recommendations draw a distinction between rule changes that directly impact the interoperability arrangement (which require agreement between the interoperating CCPs) and those which do not directly impact the interoperability arrangement (and which only need to be notified). With regards to the requirement to notify rule changes (Guideline and Recommendation 3(a)(v)(a)), this is no different to what ESMA understands to be current market practice with regards to clearing members, namely that CCPs notify clearing members of any rule changes. ESMA does not consider that it would be a significant additional administrative burden for CCPs to share such rule changes with their interoperating CCPs. Even if a rule change does not directly impact the interoperability arrangement,

the fact that a rule change is made by a CCP might be useful information in the context of an interoperating CCP's analysis of the potential risks posed by the interoperability arrangement as a whole and ESMA considers it important that such information be made available. On balance, ESMA does not consider that the costs of making such information available outweigh the benefits of doing so.

19. With regards to the requirement to agree certain rule changes (Guideline and Recommendation 3(a)(v)(b)), ESMA notes that the requirement only applies to rule changes that will directly impact the interoperability arrangement. The scope of application of the requirement is therefore much narrower than the requirement to inform under Guideline and Recommendation 3(a)(v)(a).
20. The underlying concern sought to be addressed by this requirement was that CCPs should be made aware of, and have the opportunity to influence, any rule changes that could result in potential new or changed risks arising from an interoperability arrangement. While there is a separate requirement for a process of dispute resolution, without a requirement that certain rule changes be agreed in advance, such a process might not provide relief for an interoperating CCP until sometime after a rule change has come into effect. Dispute resolution processes will also likely take time to work through. If certain rule changes are not agreed in advance then it is likely that an interoperating CCP would be exposed to potential new risks or increased risks for a period of time which is not desirable. On balance, ESMA has not changed the drafting of this Guideline and Recommendation.
21. One trade association submitted that the process for informing interoperating CCPs of rule changes does not mention any timeframes, proposing that rule changes should be subject to a prior notice period and suggesting that the Guidelines and Recommendations should specify how rule changes should be agreed upon by interoperating CCPs. ESMA considers that any further specification would be out of line with the level at which the Guidelines and Recommendations are currently pitched. The Guidelines and Recommendations require the existence of a process for informing and agreeing rule changes. In fact, the approach taken in respect of most aspects of the Guidelines and Recommendations is to require the existence of a process, generally without further specifying how that process should be structured. ESMA does not consider that sufficient reason exists to depart from the general approach in this instance – i.e. to specify certain aspects of the process such as timeframes or the mechanics of how agreement should be reached.
22. One market infrastructure suggested that the Guidelines and Recommendations should include requirements regarding the processes for dealing with buy-ins. The mandate set out for ESMA in Article 54 of EMIR does not extend to prescribing requirements for such an assessment and. It is also noted that the Short Selling Regulation should govern these arrangements and in light of this Regulation any carve out would be difficult.
23. One trade association was concerned about risk committee involvement in changes to interoperability arrangements. This is a concern which has been analysed above in respect of Guideline and Recommendation 1(a).
24. Another trade association questioned the need for a separate assessment of interoperability arrangements where three or more CCPs are involved. This is a concern which is analysed below in respect of Guideline and Recommendation 3(c).
25. NB: for a discussion of Guideline and Recommendation 3(a)(vii) see the analysis of comments on Guideline and Recommendation 3(d).

26. ESMA has made a drafting change to the general provision in this Guideline and Recommendation but this change is stylistic and not intended to change the substance of the provision. ESMA has made various minor drafting changes to the detailed provisions in this Guideline and Recommendation for the sake of clarification but these are not intended to change the substance of the provisions.

Identification, monitoring and management of risks – (b) Prudential requirements

27. One respondent was concerned that a CCP should not contribute to the default fund of another CCP.

28. ESMA considers that the Guidelines and Recommendations were already sufficiently specific in preventing one CCP from contributing to the default fund or other financial resources of an interoperating CCP with such a prohibition being necessary based on EMIR. However, in light of the potential for confusion regarding this point, ESMA has revised the current drafting to clarify more explicitly that a CCP should not contribute to the default fund or other financial resources of an interoperating CCP.

29. One CCP suggested that CCPs should be required to collect financial resources from interoperating CCPs to at least the same degree of coverage as for clearing members, including in light of the fact that a CCP cannot receive contributions to its default fund from interoperating CCPs. ESMA has made drafting changes to this Guideline and Recommendation to clarify the level of financial resources that a CCP should have access to with regards to interoperating CCPs.

30. ESMA has made a drafting change to the general provision of this Guideline and Recommendation but this is stylistic and not intended to change the substance of the provision.

Identification, monitoring and management of risks – (c) Interoperable CCP default

31. Comments on this Guideline and Recommendation all came from CCPs though there was no main theme, with respondents addressing various different aspects of the Guideline and Recommendation. The comments are considered in turn.

32. Two CCPs submitted that portability of positions cannot be assumed upon the default of an interoperating CCP. These comments addressed Guideline and Recommendation 3(c)(i)(b) which provides that CCPs should assess the degree to which the portability of positions would contribute to the lowering of the inter-CCPs exposures. While the respondents submitted that in undertaking such an assessment, a CCP should not assume that portability would occur, ESMA notes that the proposed Guidelines and Recommendations do not suggest that CCPs make such an assumption. Instead, this Guideline and Recommendation requires CCPs to do the opposite and actually assess the degree to which positions would likely be ported. In the course of considering this provision, ESMA did however identify that the reference to a 'dedicated default fund' could be better explained. In this regard ESMA has amended this Guideline and Recommendation.

33. One CCP submitted that assessment of the risk profile of an interoperating CCP should explicitly include all existing interoperability arrangements. ESMA considers this comment to likely have been addressed at the general provision of this Guideline and Recommendation rather than the detailed provisions because these already require that a CCP assesses whether any additional risks are posed where more than two CCPs participate in an interoperability agreement. ESMA has considered whether the general provisions of this Guideline and Recommendation should be amended to include a specific reference to situations where more than two CCPs participate in an interoperability agreement. The general provision of this Guideline and Recommendation does, however, already require that a CCP identify, monitor and manage the potential risks arising from the interoperability arrangement. This requirement is not specific to assessment of the potential risks arising from any one particular interoperating CCP, but requires assessment of the potential

risks arising from the entire interoperability arrangement. ESMA therefore considers that this concern is already addressed.

34. With regards to Guideline and Recommendation 3(c)(i)(d), one CCP submitted that the term ‘contagion risk’ should be defined. ESMA has considered whether the meaning of this term is sufficiently clear. While the term is not used elsewhere in the Guidelines and Recommendations, or in the text of EMIR, ESMA considers that the term ‘contagion risk’ is not so abstract that its meaning will be unclear to CCPs. Nevertheless, ESMA has amended this Guideline and Recommendation to better explain the concept.

35. ESMA has also made a drafting change to the general provision in this Guideline and Recommendation but this is stylistic and not intended to change the substance of the provision.

#### Identification, monitoring and management of risks – (d) Different risk-management models default

36. It is noted that Guideline and Recommendation 3(a) is also relevant to the consideration of comments on Guideline and Recommendation 3(d). Comments received in relation to both Guidelines and Recommendations are discussed here.

37. All five CCP respondents commented on this Guideline and Recommendation, in addition to one market infrastructure provider and one trade association. All respondents argued against the suggestion that interoperating CCPs should harmonise their risk management frameworks.

38. These arguments can be summarised as follows:

- EMIR already provides for minimum harmonised standards for CCP risk management frameworks. EMIR also explicitly recognises that different risk management frameworks may exist between CCPs.
- There is a need to avoid the contagion risk which might follow from flaws in one CCP’s risk management framework being incorporated into the risk management framework of multiple CCPs.
- Harmonisation might lead to a lack of due diligence/work on the part of CCPs to improve their risk management frameworks.
- Harmonisation ignores the fact that different underlying factors drive the risk management framework of a CCP. Harmonisation would compromise CCP independence.

39. As respondents pointed out, the purpose of EMIR is to establish minimum standards for CCP risk management frameworks and to ensure that these are applied in a harmonised way across the European Union. The legislator, in drafting EMIR, has recognised that different risk management frameworks may exist between CCPs and has allowed CCPs a degree of flexibility in the design of their risk management frameworks. If the Guidelines and Recommendations require that risk management frameworks be harmonised then a choice by one CCP to establish practices that are super-equivalent to EMIR may effectively require the replication of such practices across all interoperating CCPs. In that case, the Guidelines and Recommendations would have the effect of requiring CCPs to comply with minimum standards above those established by legislators and ESMA.

40. On the other hand, material differences in the risk management frameworks of interoperating CCPs might result in the existence of complex risks. It is necessary to ensure that such risks are identified, evaluated and mitigated.

41. Turning to the specific provisions of the Guidelines and Recommendations, there was a requirement in Guideline and Recommendation 3(d)(i) for a CCP to have a process for identifying, and assessing any risks arising from, differences between the risk management framework and membership policies of the CCP and of those CCPs with which the CCP interoperates. There was also a requirement in Guideline and Recommendation 3(a)(vii) for a CCP to have a process for assessing the need for harmonisation of their respective risk management frameworks.
42. In light of the feedback received, ESMA has revised this Guideline and Recommendation. ESMA has replaced the word 'the' with the word 'any' in Guideline and Recommendation 3(d)(i). As previously drafted, this Guideline and Recommendation implied that risks would necessarily arise from there being differences between the risk management frameworks of interoperating CCPs.
43. ESMA has also deleted Guideline and Recommendation 3(a)(vii) and incorporated the objective of that Guideline and Recommendation (namely the aspect regarding assessment of the need for harmonisation) into Guideline and Recommendation 3(d)(i). ESMA has also amended the resultant Guideline and Recommendation to remove reference to an assessment of differences in membership controls, on the basis that this is already addressed in Guideline and Recommendation 3(e).
44. The resultant text is in line with Principle 20 of the CPSS-IOSCO PFMI and Article 52(2) of EMIR.
45. Finally, ESMA has made a drafting change to the general provision of this Guideline and Recommendation but this is stylistic and not intended to change the substance of the provision.

#### Identification, monitoring and management of risks – (e) Risk profile and membership criteria

46. Views on this topic were almost evenly matched, with some respondents (including CCPs, a market infrastructure and clearing member representatives) supporting assessment of the membership criteria of an interoperating CCP and other respondents (CCPs and clearing member representatives) objecting to such an assessment.
47. No specific arguments were advanced in favour of the assessment of the membership criteria of an interoperating CCP but a number of arguments were made against such an assessment. These arguments can be summarised as follows:
  - Interoperating CCPs have exposures to each other and not to their members.
  - It is difficult to derive a correlation between the membership criteria of a CCP and the propensity for that CCP's members to default.
  - EMIR expressly requires an NCA to review a CCP's membership criteria before granting an authorisation and any further evaluation is duplicative.
  - Access criteria may necessarily be different between CCPs, due to a CCP's historical role as sole clearer of a particular market.
  - It is unclear how a CCP would receive the information necessary to evaluate this.
48. ESMA considers that assessment of membership policies is an important part of the overall risk assessment of an interoperating CCP, on the basis that the ability of a CCP to withstand a stress scenario will be impacted by the ability of its members to themselves withstand such circumstances. However, in light of the feedback received, ESMA has amended this Guideline and Recommendation to better place emphasis on the assessment of the holistic risk profile of an interoperating CCP as opposed to on this one aspect of an interoperating CCP's risk profile.

49. One market infrastructure respondent suggested that the Guidelines and Recommendations should go further in respect of the assessment of membership criteria, suggesting that CCPs should monitor the creditworthiness of the clearing members of an interoperating CCPs. In light of the above analysis, and the difficulty CCPs might have in obtaining information necessary to undertake such an analysis, ESMA does not consider that the Guidelines and Recommendations should be amended in this regard.
50. One CCP also suggested that assessment of the membership policies of all trading venues served by an interoperating CCP should be undertaken. The mandate set out for ESMA in Article 54 of EMIR does not extend to prescribing such requirements and ESMA has not amended the Guidelines and Recommendations in this regard.
51. A concern raised by one CCP was that identification, monitoring and management of the potential risks arising from an interoperability arrangement should be undertaken on a regular basis. That CCP argued that it is not possible for a CCP to ‘constantly’ monitor the risks arising from interdependencies between interoperating CCPs. ESMA considers that while it would perhaps be difficult for a CCP to monitor some of the potential risks arising from an interoperability arrangement in ‘real-time’, the requirement for regular monitoring is important because it emphasises that assessment by a CCP should not be forgotten once the interoperability arrangement has been established, but should continue to be conducted on an on-going basis. To clarify this ESMA has amended use of the term ‘constantly’ to ‘regular’.
52. ESMA has also made a drafting change to the general provision of this Guideline and Recommendation but this is stylistic and not intended to change the substance of the provision.

#### Identification, monitoring and management of risks – (f) Exposure management

53. Both of the respondents to this Guideline and Recommendation commented on whether CCPs should use different risk management parameters for interoperating CCPs than for clearing members. The CCP respondent submitted that the use of different risk management parameters would not necessarily weaken a CCP’s risk management framework; whereas the clearing member representative submitted that interoperating CCPs should not be treated any differently from a clearing member.
54. A preference for either one of these approaches is not expressed in the Guidelines and Recommendations. Instead, the Guidelines and Recommendations leave it up to the CCP to determine how it is going to calculate inter-CCP margins, albeit with a requirement that the CCP explain to its NCA any differences between the risk management parameters applied to inter-CCP exposures as opposed to those applied to clearing members. ESMA has considered whether a preference for one approach should be specified in the Guidelines and Recommendations, however notes that respondents did not advance considerable (in terms of number or weight) arguments in favour of doing so and ESMA has not changed the drafting of this provision.
55. ESMA has made a drafting change to the general Guidelines and Recommendations but this is stylistic and not intended to change the substance of the provision.

### **III.IV Guideline and Recommendation 4**

#### Deposit of collateral

56. The comments submitted on this Guideline and Recommendation mainly involved suggestions for additional restrictions on collateral accepted and how it should be required to be held by CCPs in order to ensure that it is available when required.

57. One CCP proposed that an interoperating CCP should be prevented from accepting financial instruments issued by the Member State in which their interoperating CCP is established. This suggestion, and the suggestion that an interoperating CCP should consider the systemic importance of an interoperating CCP when setting collateral policies, concern the collateral accepted by a CCP rather than the arrangements under which such collateral is deposited. The acceptability or otherwise of collateral is prescribed by Article 46 of EMIR and Chapter X of Commission Delegated Regulation (EU) No 153/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 with regard to regulatory technical standards on requirements for central counterparties. In developing its advice on this Commission Regulation, ESMA carefully considered the issues that have been raised by this respondent and ESMA does not consider it appropriate to either restate, or to further clarify, collateral requirements in the format of this Guideline and Recommendation.
58. One CCP proposed that an interoperating CCP should be required to ensure that collateral will be available and can be liquidated in a timely manner. Such a requirement is already prescribed in Guideline and Recommendation 2(b) and ESMA does not consider it appropriate to either restate, or to further clarify, such requirement in this Guideline and Recommendation.
59. A trade association submitted that interoperating CCPs should be allowed to deposit collateral received from an interoperating CCP in the same manner as they deposit collateral received from their clearing members. ESMA notes that a CCP is not prevented from depositing collateral received from an interoperating CCP in the same manner as it deposits collateral received from a clearing member. The Guidelines and Recommendations do not introduce alternative requirements to those established in Article 47 of EMIR or Chapter XI of Commission Delegated Regulation (EU) No 153/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 with regard to regulatory technical standards on requirements for central counterparties; instead the Guidelines and Recommendations seek to highlight additional considerations that a CCP should have in mind when depositing collateral received from an interoperating CCP. ESMA does not consider it appropriate to either restate, or to further clarify, requirements in the format of this Guideline and Recommendation or to establish alternative requirements specific to the deposit of collateral received from an interoperating CCP.
60. One trade association proposed that interoperating CCPs should be required to ensure that collateral will be available when required, including in the case of an interoperable CCP default. ESMA notes that such a requirement is already prescribed in Guidelines and Recommendations 2(a) and 2(b) and ESMA does not consider it appropriate to either restate, or to further clarify, such requirement in the format of this Guideline and Recommendation.
61. ESMA has deleted the detailed provisions of this Guideline and Recommendation that were proposed for consultation on the basis that this provision duplicated requirements already expressed in Guideline and Recommendation 3(b).

### **III.V Guideline and Recommendation 5**

#### Cooperation between NCAs

62. One market infrastructure raised concern that Guideline and Recommendation 5(1) might require CCPs to share some of their intellectual property. While the information shared by NCAs might include the intellectual property of a CCP, or similarly commercially sensitive material, NCAs are bound by professional secrecy requirements as set out in Article 83 of EMIR. Any commercially sensitive information that one NCA shared with another would be protected by such professional secrecy. With this in mind ESMA does not consider it appropriate to amend this Guideline and Recommendation.

63. One trade association expressed concern that Guideline and Recommendation 5 is only targeted at cooperation during the initial assessment of an application for the establishment of an interoperability arrangement and not cooperation on a regular basis. While cooperation on a regular basis is important, ESMA considers that it is already sufficiently prescribed for in EMIR (i.e. Article 18 on college arrangements). Nevertheless, ESMA has amended the Guidelines and Recommendations to recall that cooperation is required on a regular basis.

### III.VI Question 1

Do you think that the draft Guidelines and Recommendations adequately capture all the relevant considerations for an NCA when receiving an application from a CCP to establish an interoperability arrangement?

64. The submissions from one CCP and one market infrastructure suggested that the Guidelines and Recommendations should include requirements regarding the evaluation of processes for dealing with buy-ins and inter-CCP deliveries. The mandate set out for ESMA in Article 54 of EMIR does not extend to prescribing requirements for such an assessment and ESMA has not amended the Guidelines and Recommendations in this regard.

65. The comments of two CCPs suggested that the Guidelines and Recommendations are too detailed. These suggestions are difficult to analyse at a holistic level but where comments have been made about specific aspects of the Guidelines and Recommendations then these have been analysed and addressed in the context of the relevant Guidelines and Recommendations, for example in the changes made to Guideline and Recommendation 1.

### III.VII Question 2

Are there areas where it would be helpful to have more detail on the relevant considerations for an NCA when receiving an application from a CCP to establish an interoperability arrangement? If so, please specify what those details should be?

66. The submission from one CCP suggested that the Guidelines and Recommendations should include requirements to ensure fair and open access at an earlier stage of the interoperability assessment process. The context of this comment indicated that some form of requirements for trading platforms was envisaged by the respondent. The mandate set out for ESMA in Article 54 of EMIR does not extend to prescribing such requirements and ESMA has not amended the Guidelines and Recommendations in this regard.

67. The submission from one trade association suggested that the Guidelines and Recommendations should include requirements regarding the evaluation of processes for dealing with settlement failures. The mandate set out for ESMA in Article 54 of EMIR does not extend to prescribing requirements for such an assessment and ESMA has not amended the Guidelines and Recommendations in this regard.

### III.VIII Question 3

Is it appropriate to consider an assessment by CCPs of the membership criteria of interoperable CCPs?

68. Comments submitted in response to this question directly concern Guideline and Recommendation 3(e) and have been considered as part of ESMA's analysis of submissions on that Guideline and Recommendation. Please see above.



### III.IX Question 4

Do you have additional comments on the draft Guidelines and Recommendations?

69. The comment of one CCP pertained to interoperability for derivative instruments. While it is expected that NCAs will apply ESMA's Guidelines and Recommendations to interoperability arrangements for products other than transferable securities or money-market instruments and expected that CCPs will have regard to the provisions in Title V of EMIR when structuring such interoperability arrangements, this is not an explicit requirement and so ESMA considers it inappropriate to incorporate in the Guidelines and Recommendations requirements that are specific to interoperability arrangements for products other than transferable securities or money-market instruments.
70. One market infrastructure suggested that ESMA's Guidelines and Recommendations mandate interoperability. The Guidelines and Recommendations do not mandate interoperability. The respondent also suggested that interoperability arrangements be reassessed on a regular basis. This is already addressed by the general provision in Guideline and Recommendation 3 which provides that an NCA should assess that a CCP has put in place a general framework to identify, monitor and manage, both before entering into an interoperability arrangement and on a regular basis, the potential risks arising from the interoperability arrangement. Amendment to Guideline and Recommendation 3 is not considered necessary but ESMA has amended Guideline and Recommendation 2(b) concerning legal analysis to require that such analysis be conducted on a regular basis.
71. One trade association submitted that the Guidelines and Recommendations should include requirements for trading venues in order to ensure the Guidelines and Recommendations do not reinforce closed monopolies. The mandate set out for ESMA in Article 54 of EMIR does not extend to prescribing requirements for trading venues and ESMA has not amended the Guidelines and Recommendations in this regard.

**ANNEX I – List of respondents to ESMA’s Consultation Paper on Guidelines and Recommendations for establishing consistent, efficient and effective assessments of interoperability arrangements**

<b>Name of respondent</b>	<b>Type of respondent</b>
Eurex Clearing	CCP
European Central Counterparty Limited	CCP
European Multilateral Clearing Facility N.V. Amsterdam	CCP
LCH.Clearnet Group	CCP
SIX X-Clear	CCP
FWB, Frankfurt Stock Exchange	Market Infrastructure
NYSE Euronext	Market Infrastructure
London Stock Exchange Group	Market Infrastructure
BVI	Trade Association
Federation of Finnish Financial Services	Trade Association
International Swaps and Derivatives Association, Inc.	Trade Association
The Alternative Investment Management Association Limited	Trade Association
The Association for Financial Markets in Europe	Trade Association

## ANNEX II – Cost-benefit analysis

### I. Introduction

1. The objective of performing a cost-benefit analysis is to assess the costs and benefits of the various policy or technical options which were analysed during the process of drafting the Guidelines and Recommendations. The Guidelines and Recommendations on interoperability arrangements (IA) are specific in that they do not aim to prescribe further requirements for market participants, neither do they aim to revise the approval process for CCPs. Therefore there should be no material additional compliance costs for market participants associated with them. The only costs should be for regulators. Although it is true that CCPs will need to submit their applications on interoperable arrangements in a manner that allows NCAs to assess them in line with the Guidelines and Recommendations, it should also be considered that the Guidelines and Recommendations will harmonise the treatment of these applications among NCAs and under the Guidelines and Recommendations applicant CCPs will be better able to provide NCAs with the relevant information.
2. The benefits of interoperability and the policy choices evaluated in prescribing requirements for interoperability, and in limiting those requirements in the first phase to interoperability in respect of cash instruments, were assessed by the European Commission when presenting its proposal for EMIR<sup>1</sup>. The choices or options envisaged by ESMA while drafting these Guidelines and Recommendations were therefore limited to (1) identifying the details necessary for a NCA to consider when conducting an assessment of an interoperability arrangement to ensure that such assessments are consistent, efficient and effective across CCPs, and (2) identifying considerations necessary for a NCA to consider in determining that an interoperating CCP continues to comply with the provisions of EMIR and the technical standards.
3. Therefore the following cost-benefit analysis is exclusively qualitative and presents general considerations rather than providing detailed tables of options and their relative advantages and disadvantages.

### II. How detailed should the Guidelines and Recommendations be?

4. When drafting the Guidelines and Recommendations, ESMA considered the level of granularity which they should entail. ESMA considered that if the Guidelines and Recommendations are defined in an overly broad manner it might leave room for different interpretations among NCAs in the course of their assessments of IA. In that respect, the risks would be twofold.
5. Firstly, there would be a risk that some jurisdictions might tend to limit or prevent the establishment of IA in a disproportionate manner. An indirect consequence of this would be a limited ability for CCPs to enter into IA, resulting in market participants not having the possibility to use their preferred CCPs. Instead their choice would be limited to the CCPs that operate with the relevant trading venue. Interoperability increases competition, which in turn reduces the costs of clearing and consequently increases the ability of counterparties to trade, resulting in higher trading volumes and enhanced liquidity. Therefore ESMA considered that Guidelines and Recommendations defined in an overly broad manner might result in increased costs for market participants. This would go against the stated aim that there be no material additional costs for market participants associated with the Guidelines and Recommendations.
6. Interoperability arrangements also represent a way of reducing risk in the global CCP system by alleviating concentration of risk within single CCPs. Disproportionate limits on the establishment of IA might therefore

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<sup>1</sup> [http://ec.europa.eu/internal\\_market/financial-markets/docs/derivatives/20100915\\_impact\\_assessment\\_en.pdf](http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/20100915_impact_assessment_en.pdf)

have the effect of preventing such reduction of risk. If such risk were to crystallise there would be a cost to market participants, regulators and potentially to society as a whole.

7. ESMA also considered that Guidelines and Recommendations defined in an overly broad manner might create the risk that the assessment of IA does not encompass a sufficiently thorough analysis of a CCP's ability to identify, monitor and manage the risks arising from those arrangements. The indirect consequence of this might be that CCPs enter into IA without being duly prepared to face, for example, the default of the CCP with which they interoperate.
8. Given that IAs create a network of CCPs with strong interdependencies and can introduce contagion risk into the global CCP system, ESMA considered that sufficiently detailed Guidelines and Recommendations are necessary to ensure the proper assessment of those risks and dependencies and therefore to promote the safety of the global CCP system. ESMA considers that sufficiently detailed Guidelines and Recommendations are necessary to ensure that NCAs perform their assessment of IA in a harmonised way, therefore ensuring that European CCPs willing to establish IA will face equal conditions.
9. ESMA does however recognise the need to ensure that the Guidelines and Recommendations are not overly prescriptive such that they restrict the circumstances in which IA can be established or impose a particular model or way of managing the risks presented by the IA.
10. ESMA also recognises that there is a cost to NCAs of more detailed Guidelines and Recommendations, namely that NCAs will need to assess IA against a more detailed set of standards.
11. Against this background, ESMA has identified certain aspects of Articles 51 to 54 of EMIR in respect of which it considers it necessary to prescribe detailed Guidelines and Recommendations for NCAs to follow in assessing IA.
12. Where these detailed Guidelines and Recommendations involved specific policy choices which might give rise to material cost implications then these are discussed below.

### **III. Guideline and Recommendation on Legal basis**

13. Regarding the legal basis of the IA, ESMA specifically contemplated how the Guidelines and Recommendations should define the type of documentation that NCAs should take into account when performing their assessments.
14. One option considered was to include in the assessment by NCAs a review of all of the processes, procedures, policies and models, etc. of the interoperable CCPs, while another option considered was to limit the scope of the review to the documents related to the IA itself. The distinction between option 1 and option 2 came down to a question of transparency versus cost. The first option has the advantage of full transparency between NCAs and the CCPs with which their CCPs will interoperate, but which is more costly in terms of the scope of assessment to be performed by NCAs. Such cost would also be duplicative because each CCP entering into an IA is necessarily a CCP which has already been authorised or recognised under EMIR. Therefore the CCP's full set of processes, procedures, policies and models, etc. will have already been assessed by the CCP's NCA under a process which is clearly defined in EMIR. The value added by this second full review was considered to likely be limited and therefore the additional cost to NCAs unjustified.
15. Under EMIR, NCAs will become members of the colleges of the CCPs with which their CCPs interoperate. Although participation in the college will only become effective after the IA is concluded, this process should give NCAs sufficient comfort that they will be aware of any change in the processes, procedures, policies and models, etc. related to an IA. Considering all the elements above, the second option was considered the

most appropriate balance between costs and benefits. ESMA notes that the second option will require that the rights and obligations of the CCP under the IA, and the processes, procedures, policies and models related to the IA, be sufficiently documented and that such documentation will need to be subject to adequate process (e.g. review, responsibility, consultation of the risk committee). However, ESMA does not consider this to be an additional cost for CCPs entering into interoperability arrangements because sufficient documentation and adequate process are already requirements imposed upon CCPs by EMIR.

#### **IV. Guideline and Recommendation on the identification, monitoring and management of risks**

16. Regarding the risk management of IA, ESMA identified a number of matters for NCA's to consider in determining that an interoperating CCP continues to comply with the provisions of EMIR. In particular, the Guidelines and Recommendations considered exchange of information and membership criteria which might have material cost implications:

##### **1. Exchange of information**

17. Article 52(1)(c) of EMIR provides that CCPs entering into IA shall identify, monitor and effectively manage credit and liquidity risks so that the default of a clearing member of one CCP does not affect an interoperable CCP. In drafting the Guidelines and Recommendations ESMA had to specify the extent to which NCAs should expect to find that CCPs assess the processes of one another.

18. ESMA identified that interoperable CCPs are competitors because they serve the same markets. ESMA therefore considered that the Guidelines and Recommendations should not unduly force CCPs to exchange sensitive or confidential information which would place them at a competitive disadvantage. On the other hand, ESMA considered that even though EMIR aims to harmonise the risk management and operational frameworks of CCPs, it also provides CCPs with sufficient flexibility to adopt processes, procedures, policies and models adapted to the specificities of their business, which may lead to interoperable CCPs operating under quite different risk management frameworks from one another. ESMA therefore considered that NCAs should expect to find that IA contain a certain degree of specification regarding information sharing between CCPs and the processes by which the CCPs will communicate and/or agree with each other regarding events that might affect the IA.

19. ESMA therefore sought to achieve a balance between a high level of prescription (which could force CCPs into exchanging commercially sensitive information) and a lower level of prescription (which risks CCPs not being aware of, or not being able to properly mitigate, the risks related to IA).

20. To strike an appropriate balance taking those constraints into account, ESMA has specified in the Guidelines and Recommendations what NCAs should expect to find in terms of when, how and what interoperable CCPs communicate with each other. ESMA has also specified Guidelines and Recommendations regarding the process that NCAs should expect to find regarding notification of changes between interoperating CCPs and consultation where such changes might have a direct impact on the IA.

##### **2. Membership criteria**

21. ESMA considered whether NCAs should expect to find that a CCP has assessed the membership criteria of the CCPs with which it interoperates. ESMA identified that weak membership criteria at one CCP might present risks to the CCPs with which that CCP interoperates. ESMA therefore considered that there might

be costs for an NCA to not assess whether membership criteria have been adequately assessed by the interoperating CCPs.

22. However, ESMA also identified that encouraging CCPs to assess each other's membership criteria might raise competition issues. For example, one CCP could be limited in its ability to modify its membership criteria because the CCPs with which it interoperates could claim that these modifications give rise to a risk related to the IA. This could leave room for IA to be assessed on criteria other than risk, e.g. for commercial reasons, which should be avoided. The costs of preventing IA on competition grounds are noted by ESMA as articulated earlier in this assessment.
23. In addition, for the reasons already explained under the assessment of Guideline and Recommendation 1 on legal risks, CCPs are not supposed to assess requirements already assessed by the relevant NCA, thus duplicating their job.
24. Against this background, ESMA considers that interoperating CCPs should assess the risk arising from the membership policies of an interoperable CCP. This would be part of the overall risk assessment and it is not expected to result in interference by an interoperating CCP in the application of the policies of another CCP.
25. The approach now employed in the Guidelines and Recommendations is a more balanced and less intrusive approach and is not expected to have a negative impact on the actual establishment of interoperability arrangements, risks which were highlighted by respondents in respect of the approach presented by ESMA in its consultation paper.

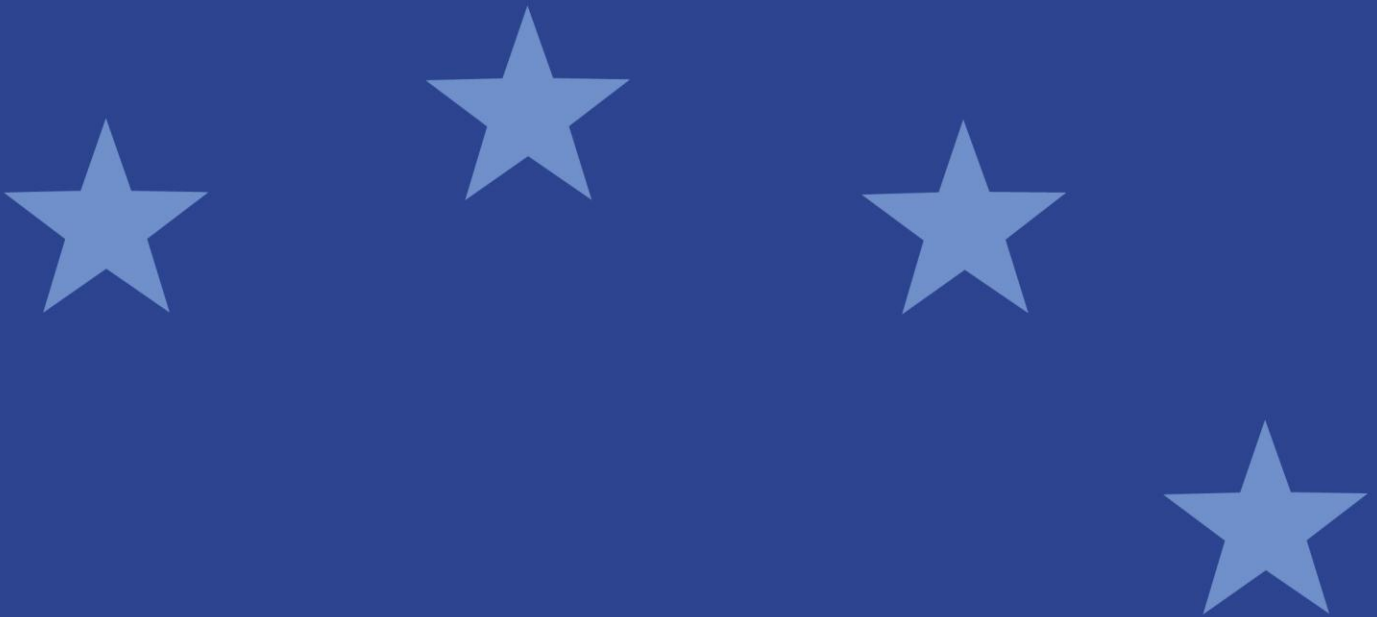


**ANNEX III - Guidelines and Recommendations for establishing consistent, efficient and effective assessments of interoperability arrangements**



# Guidelines and Recommendations

Guidelines and Recommendations for establishing consistent, efficient and effective assessments of interoperability arrangements







Date: XX.XX 2013

ESMA/2013/322

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## **I. Scope**

### **Who?**

1. These Guidelines and Recommendations apply to national competent authorities (NCAs).

### **What?**

2. The Guidelines and Recommendations define what NCAs should analyse in assessing an interoperability arrangement and therefore on what aspects of the interoperable arrangement the relevant CCPs will need to focus their attention.
3. The Guidelines and Recommendations do not introduce new requirements for CCPs in addition to the ones specified in EMIR or the relevant technical standards. However, they specify how those requirements should be met for the purpose of establishing robust and stable interoperability arrangements.
4. The Guidelines and Recommendations focus on the risks that might arise from interoperability arrangements and outline the areas on which CCPs should focus, and which NCAs should verify, to mitigate those risks.

### **When?**

5. These Guidelines and Recommendations apply from [*date*].

## **II. Purpose**

6. The objective of these Guidelines and Recommendations is to improve the rigor and uniformity of standards applied in the assessments of interoperability arrangements.

## **III. Compliance and reporting obligations**

### **Status of the guidelines**

7. This document contains General Guidelines and Recommendations and Detailed Guidelines and Recommendations. Both types are Guidelines and Recommendations issued under Article

16 of the ESMA Regulation<sup>2</sup>. In accordance with Article 16(3) of the ESMA Regulation NCAs must make every effort to comply with Guidelines and Recommendations.

8. NCAs to whom the Guidelines and Recommendations apply should comply by incorporating them into their supervisory practices.

### **Reporting requirements**

9. NCAs to whom these Guidelines and Recommendations apply must notify ESMA whether they comply or intend to comply with the Guidelines and Recommendations, with reasons for non-compliance, within two months of the date of publication by ESMA to [post-trading@esma.europa.eu](mailto:post-trading@esma.europa.eu). In the absence of a response by this deadline, NCAs will be considered as non-compliant. A template for notifications is available from the ESMA website.

## **IV. Guidelines and Recommendations for establishing consistent, efficient and effective assessments of interoperability arrangements**

10. Considering the requirements for CCPs entering into an interoperability arrangement as set out in Articles 51, 52 and 53 of the Regulation, ESMA proposes that NCAs, when reviewing an interoperability proposal pursuant to Article 54 of the Regulation, assess the application against the criteria set out in the Guidelines and Recommendations below.

### **GUIDELINE AND RECOMMENDATION ONE: LEGAL RISK**

(Article 52(1)(a) and (b) of Regulation (EU) No 648/2012)

#### *General Guideline and Recommendation 1*

A NCA should assess that the interoperability arrangement is clearly defined, transparent, valid and enforceable in all relevant jurisdictions and also that a CCP has put in place a framework to assess these factors before entering into an interoperability arrangement and on a regular basis.

#### *Detailed Guidelines and Recommendations*

##### **a) Documentation**

In applying general Guideline and Recommendation 1, NCAs should at least take into account that the documentation:

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<sup>2</sup> Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC.

- i. Clearly identifies, in a form that is binding, the rights and obligations of the CCPs under the interoperability arrangement.
- ii. Is compatible with the risk mitigation processes of the CCP.
- iii. Establishes a process for regular review of the documentation, which ensures that the documentation remains appropriate and defines the responsibilities of the CCPs in that process.
- iv. Establishes a process to consult the risk committee and the clearing members where the establishment of, or any change to, the interoperable arrangement is likely to have a material impact on the risks to which the CCP is exposed, and to inform the clearing members where the establishment of, or any change to, the interoperable arrangement may have an impact on their operations.
- v. Clearly indicates the process and the persons responsible for monitoring and ensuring the functioning of the interoperability arrangement.
- vi. Clearly defines the dispute resolution mechanism for disputes arising from the interoperability arrangement.
- vii. Clearly defines the conditions and procedure for termination of the interoperability arrangement.

## **b) Legal analysis**

When applying general Guideline and Recommendation 1, NCAs should at least take into account the following:

- i. That the CCP has assessed with a high degree of confidence that the netting arrangements between the interoperating CCPs are valid and enforceable.
- ii. That the CCP has assessed with a high degree of confidence that its rules and procedures concerning the moment of entry of transfer orders into its systems and the moment of irrevocability have been defined in accordance with Article 52(1) of the Regulation.
- iii. That the CCP has assessed with a high degree of confidence the potential for cross-border legal issues to arise as a result of its participation in the interoperable arrangement, in particular with regard to its default procedures and the enforceability of collateral arrangements.
- iv. That the CCP has assessed with a high degree of confidence that its procedures for the management of the default of the interoperable CCP are valid and enforceable.
- v. That the CCP has a high degree of confidence regarding the enforceability of its default rules against the interoperable CCPs and regarding the viability of its interoperability procedures.

## **GUIDELINE AND RECOMMENDATION TWO: OPEN AND FAIR ACCESS**

(Article 51(2) and (3) of Regulation (EU) No 648/2012)

### *General Guideline and Recommendation 2*

A NCA should assess that the interoperability arrangement ensures non-discriminatory access and that denial or restrictions on entering into an interoperability arrangement are based only on risk grounds.

### *Detailed Guidelines and Recommendations*

### **a) Documentation**

In applying general Guideline and Recommendation 2, NCAs should at least take into account that the documentation:

- i. Governing the interoperability arrangement does not contain any provision that restricts or creates obstacles for the establishment or future extension of the interoperability arrangement to other CCPs, other than on duly justified risk grounds.
- ii. Governing the interoperability arrangement does not unduly restrict the termination of the interoperability arrangement where one of the interoperating CCPs considers it necessary to terminate it on duly justified risk grounds. In such circumstances, the CCP deciding to terminate the interoperability arrangement needs to provide adequate justification to its NCA of its reasons to terminate the arrangement and provide clearing members, trading platforms served by the CCP and other interoperable CCPs, where appropriate, with as much notice as possible.

## **GUIDELINE AND RECOMMENDATION THREE: IDENTIFICATION, MONITORING AND MANAGEMENT OF RISKS**

(Article 52(1)(a), (b) and (c) and Article 52(2) of Regulation (EU) No 648/2012)

### *General Guideline and Recommendation 3*

A NCA should assess that a CCP has put in place a general framework to identify, monitor and manage, before entering into an interoperability arrangement and on a regular basis, the potential risks arising from the interoperability arrangement.

### *Detailed Guidelines and Recommendations*

#### **a) General policies, procedures and systems**

In applying general Guideline and Recommendation 3, NCAs should at least take into account the following:

- i. That the interoperability arrangement does not impact on the compliance by the CCPs participating in the arrangement with the requirements to which they are subject under the Regulation and relevant technical standards or equivalent regulations in third countries. In this respect, these requirements should be met by each CCP on a standalone basis, in particular with reference to prefunded financial resources including margins.
- ii. That the CCPs exchange the necessary information on their operations, including, where relevant, the potential reliance on third parties as critical service providers, enabling each CCP to perform effective periodic assessments and to identify, monitor, and mitigate any new or increased risk, interdependencies or spill over effects that may arise from the interoperability arrangement.
- iii. That there is a process for the regular review of the CCP's risk management framework following the assessment in point (ii).
- iv. That there is a process for agreeing between the interoperable CCPs any changes to the interoperability arrangement and for resolving disputes.
- v. That there is a process for:

- a. informing the interoperable CCPs of any change to the rules of the CCP; and
  - b. agreeing between the interoperable CCPs any changes to the rules of one CCP that directly impacts the interoperability arrangement.
- vi. In case of interoperability arrangements involving three or more CCPs, that the CCP has defined policies, procedures and systems to identify, monitor, assess and mitigate the risks arising from the collective arrangements and the rights and obligations of the different interoperable CCPs.
  - vii. That the CCP's operational arrangements, processing capacity and risk management arrangements are sufficiently scalable and reliable for both the current and projected peak volumes of activity processed through the interoperable link and the number of CCPs involved in the interoperability arrangement.
  - viii. That the communication arrangements between the interoperable CCPs ensure timely, reliable and secure communication.
  - ix. That the CCP's default management procedures are designed to ensure that the management of a default of a clearing member of one CCP does not affect the operations of the interoperable CCPs or expose them to additional risks.
  - x. That the CCP has assessed the need for specific default management procedures in view of the interoperability arrangement.
  - xi. That the procedure for the termination of the interoperability arrangement by any of the interoperable CCPs is clear and transparent and will result in termination in an orderly manner that does not unduly expose the interoperable CCPs to additional risks.

#### **b) Prudential requirements**

In applying general Guideline and Recommendation 3, NCAs should at least take into account the following:

- i. That financial risks, including custody risks, arising from the interoperability arrangement are identified, monitored, assessed and mitigated with the same rigour as the CCP's exposures arising from its clearing members.
- ii. That the CCP has adequate processes, procedures and risk models, including methodologies for stress testing, to adequately forecast its financial exposures and liquidity needs arising from the interoperability arrangement
- iii. That the CCP has assessed, collected or has access to, the required inter-CCP resources necessary to cover credit and liquidity risk arising from the interoperable arrangement, including in extreme but plausible market conditions.
- iv. That the CCP has identified any risks arising from the interval between inter-CCP margin calls and the availability of the relevant collateral.
- v. That the interoperable CCPs are not allowed to contribute to each other's default funds or other financial resources as defined in Article 43 of the Regulation.

#### **c) Interoperable CCP default**

In applying general Guideline and Recommendation 3, NCAs should at least take into account the following:

- i. The CCP's potential exposures arising from uncovered credit losses if an interoperable CCP's default waterfall has been exhausted.
- ii. The degree to which the portability of positions from the defaulting CCP to a non-defaulting CCP or a default fund of the interoperable CCP, which is dedicated to covering the exposures

- arising from financial instruments cleared through the interoperable arrangement, would contribute to the lowering of the inter-CCPs exposures.
- iii. Ensuring that risks introduced by the interoperability arrangement are disclosed to the clearing members in line with the Article 38(2) of the Regulation and Article 10 of Commission Delegated Regulation (EU) No 153/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 with regard to regulatory technical standards on requirements for central counterparties).
  - iv. Where more than two CCPs participate in an interoperability agreement, the risks of the collective interoperability arrangement.
  - v. The likely liquidity needs resulting from the interoperability arrangement such as in the case of an inter-CCP margin call not being met.

#### **d) Different risk-management models**

In applying general Guideline and Recommendation 3, NCAs should at least take into account the following:

- i. That the CCP has a process for regularly assessing differences between the risk-management frameworks, if any, of the interoperating CCPs, identifying any risks that may arise from the use of such different models or controls, including assessment of the results of stress tests and the testing of default procedures, and has arrangements in place for mitigating those risks.
- ii. That following the assessment in point (i), there should be a process for interoperable CCPs to review their risk management frameworks and consider possible actions, including the case for further convergence of the risk management frameworks.

#### **e) Risk profile and membership criteria**

In applying general Guideline and Recommendation 3, NCAs should at least take into account the following:

- i. That the CCP has assessed the risk profile of each interoperating CCP, including any risks that may arise from its membership policies, to ascertain that the interoperability arrangement does not result in a weakening of the CCP's overall risk management framework.
- ii. That the CCP has policies, procedures and systems to regularly monitor, assess and mitigate any risk arising from interdependencies, including from entities or groups of entities acting as clearing members or providers of essential services to one or more interoperable CCP. In this respect, the concentration limits established by each CCP should be reviewed to ensure they remain appropriate in light of the interoperability arrangement, in particular if the arrangement gives rise to higher risks of interdependencies.

#### **f) Exposure management**

In applying general Guideline and Recommendation 3, NCAs should at least take into account the following:

- i. That the CCP has identified how it will cover exposures originating from the interoperability arrangement, including:
  - a. how it will calculate margin pursuant to Article 41 of the Regulation and Chapter VI of Commission Delegated Regulation (EU) No 153/2013 of 19 December 2012

supplementing Regulation (EU) No 648/2012 with regard to regulatory technical standards on requirements for central counterparties.

- b. how it will meet exposures following the default of an interoperable CCP without reducing the CCP's ability to fulfil its obligations to its own clearing members.
  - c. the assumptions for the determination and exchange of inter-CCPs margins. This should include a detailed explanation to the NCAs of the differences, if any, between the risk management parameters applied to the inter-CCP exposures as opposed to the ones applied to the clearing members.
- ii. That the CCP has put in place risk management tools, such as margin or default fund policies, to address any weakening of the CCP's overall risk management framework due to the interoperability arrangement.
  - iii. That the CCP has put in place arrangements, which are transparent to its clearing members, to meet exposures arising from the interoperability arrangement, including in extreme but plausible market conditions.

#### **GUIDELINE AND RECOMMENDATION FOUR: DEPOSIT OF COLLATERAL**

(Article 53(3) of Regulation (EU) No 648/2012)

##### *General Guideline and Recommendation*

1. A NCA should assess that an interoperable CCP deposits collateral in a way that it is protected from the default of any interoperable CCPs.

#### **GUIDELINE AND RECOMMENDATION FIVE: COOPERATION BETWEEN NCAS**

(Article 54(2) of Regulation (EU) No 648/2012)

##### *General Guideline and Recommendation*

1. Without prejudice to the authorisation procedure outlined in Article 17 of the Regulation, the NCAs responsible for the assessment of the interoperability arrangement should closely cooperate with each other during the assessment phase. This includes sharing information throughout the process and sharing their respective risk assessment reports before they are finalised and submitted to the respective colleges in line with the procedure set out in Article 17 of the Regulation. Without prejudice to the college arrangements under Article 18 of the Regulation, the NCAs responsible for supervision of the interoperable CCPs should closely cooperate with each other on a regular basis.
2. Where the interoperability arrangement is between a CCP authorised under Article 17 of the Regulation and a CCP recognised under Article 25 of the Regulation, there should be arrangements for cooperation between the NCA and the relevant third-country authority in order to respect the provisions in paragraph 1 of this Guideline and Recommendation. The establishment of the relevant arrangements may be facilitated through the cooperation arrangement between ESMA and the third-country competent authority, as established in accordance with Article 25(7) of the Regulation.