



European Securities and
Markets Authority

Final report

The extension of the scope of interoperability arrangements



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Acronyms used

CCP	Central Counterparty
CPSS	Committee on Payment and Settlement (now Committee on Payments and Market Infrastructures - CPMI)
EMIR	European Market Infrastructure Regulation – Regulation (EU) 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories
ESMA	The European Markets and Securities Authority
ETD	Exchange Traded Derivatives
IOSCO	International Organization of Securities Commissions
OTC	Over the Counter
EU	The European Union
FMI	Financial Market Infrastructure
ITS	Implementing Technical Standards
NCA	National Competent Authority
Q&A	Questions and answers
RTS	Regulatory Technical Standards
RTS on CCPs	Commission Delegated Regulation (EU) No 153/2013

1 Executive Summary

Reasons for publication

The European Securities and Markets Authority (ESMA) is publishing this report pursuant to Article 85(3)(d) of Regulation (EU) 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories (EMIR) which provides that ESMA should submit to the Commission a report on the extension of the scope of interoperability arrangements under Title V of EMIR to transactions in classes of financial instruments other than transferable securities and money-market instruments, which constitute the current scope of EMIR. This report is also to be submitted to the Council and the Parliament.

Content

First this report details how the concept of interoperability has emerged in the EU and the general EU regulatory framework applicable to it as described mainly in EMIR Articles 51 onwards and in the Guidelines and Recommendations for establishing consistent, efficient and effective assessments of interoperability arrangements¹ (the Guidelines and Recommendations).

Then it provides a mapping and a description of the current interoperability arrangements between EU CCPs for different product types i.e. EU equities, EU government bonds and EU Exchange Traded Derivatives (ETDs).

Finally it examines the reasons for extending the current EMIR framework to derivatives taking into account the corresponding costs and benefits to then conclude on the opportunity of such extension and its scope, i.e. restricted to ETDs and not yet to OTC derivatives.

Next steps

ESMA will submit the report to the Commission, the European Parliament and the Council so that its recommendation be endorsed and implemented. In the future ESMA can, if it deems it appropriate, submit another report on the need to extend further the EMIR framework to OTC derivatives.

ESMA will also, as foreseen in EMIR Article 85(4), cooperate with the Commission in the annual assessment of systemic risk and cost implication of interoperability arrangements.

¹ http://www.esma.europa.eu/system/files/2013-323_annex_1_esma_final_report_on_guidelines_on_interoperability.pdf

2 Introduction

- 1 According to recital 73 and Article 85(3)(d) of EMIR ESMA should have submitted to the Commission a report on the extension of the scope of interoperability arrangements under Title V of EMIR to transactions in classes of financial instruments other than transferable securities and money-market instruments, which constitute the current scope of EMIR. This report is also to be submitted to the Council and the Parliament.
- 2 In a letter to the Commission dated 29 September 2014² ESMA underlined that the process for the authorisation of EU CCPs was not yet completed, and it would be thus premature, in ESMA's view, to submit this report while this process was still on-going. Therefore, ESMA had postponed the submission of the report (and others) in order to be able to reflect therein the experience gained throughout the authorisation process of EU CCPs.
- 3 It is also worth noting that under Article 85(4) of EMIR, the Commission shall, in cooperation with the Member States and ESMA, and after requesting the assessment of the ESRB, draw-up an annual report assessing any possible systemic risk and cost implications of interoperability arrangements focussing at least on the number and complexities of the arrangements and the adequacy of risk management systems and models.
- 4 Now that more than 80% of EU CCPs have been authorised including those which have interoperability links, ESMA is in a position to issue its report. This report refers to the situation as of the date of its publication and is based on the public information and information ESMA has collected in the context of its participation in EU CCPs colleges.
- 5 This report contains a summary of the provisions related to interoperability in EMIR and a concise description of the corresponding links that were established in the EU. Then follows the analysis of the adequacy of the current provisions to (OTC) derivatives instruments including a very brief impact analysis. Finally it concludes on the interest in extending the scope of interoperability arrangements under Title V of EMIR.

²http://www.esma.europa.eu/system/files/esma_2014_1179_letter_to_commissison_on_esma_reports_per_art_85.pdf

3 General regulatory framework for interoperability

3.1 Definition and EMIR framework for interoperability

3.1.1 Definition and scope

- 6 Article 2 of EMIR defines an interoperability arrangement as an arrangement between two or more CCPs that involves a cross-system execution of transactions. The reference to cross-system implies that there should be a reciprocal link between the two CCPs which would allow one to clear trades through the other and vice-versa. Reciprocity was a very relevant element when differentiating interoperability from a situation where a CCP becomes the clearing member of another CCP. In the latter case reciprocity does not exist.
- 7 Recital 73 of EMIR indicates that given the additional complexities involved in an interoperability arrangement between CCPs clearing OTC derivative contracts, it is appropriate to restrict the scope of interoperability arrangements to transferable securities and money-market instruments.
- 8 This does not mean that interoperability links are prohibited for (OTC) derivatives but that interoperability on derivatives are not subject to EMIR provisions. This was clarified in paragraph 14 of the Final report on the Guidelines and Recommendations³. Interoperability in respect of (OTC) derivatives is permitted under EMIR even though the framework described in EMIR does not, yet, apply to the corresponding arrangements.
- 9 Although currently EMIR does not apply to interoperability arrangements for (OTC) derivatives, the Guidelines and Recommendations also apply to interoperability arrangements on (OTC) derivatives. Given that EMIR does not ban interoperability arrangements on (OTC) derivatives, NCAs and ESMA agreed at the time of the adoption of the Guidelines and Recommendations that should interoperability arrangements on (OTC) derivatives arise, the Guidelines and Recommendations should apply as a basis for NCAs risk assessment. However no specific recommendation was developed either for (OTC) derivatives interoperability arrangements or for specific risks arising from these arrangements.

³ http://www.esma.europa.eu/system/files/2013-323_annex_1_esma_final_report_on_guidelines_on_interoperability.pdf

3.1.2 EMIR framework

- 10 The “European Code of Conduct for Clearing and Settlement”⁴ (the Code of Conduct) dated 7 November 2006 founded a voluntary framework for establishing links between CCPs for cash equities. It aimed at enhancing transparency and increase competition in the post-trading sector.
- 11 The second pillar of the Code of Conduct was open access and competition by means of links (interoperability) in equities markets, according to which infrastructures have a reciprocal right to become members of another infrastructure, unless specific risk concerns have been identified.
- 12 This allows access to any local market without having to become a local actor. At clearing level this means that a clearing member from a country would be able to access clearing of another European market without having to become a clearing member of corresponding CCPs thanks to the inter-CCP links. Many trading and post-trading infrastructures signed the Code of Conduct however, the post-trade sector continued to be fragmented along national lines, hindering cross-border harmonisation.
- 13 In 2012 EMIR laid down the conditions for the establishment of interoperability arrangements between CCPs to ensure that they did not expose the relevant CCPs to risks that are not appropriately managed.
- 14 EMIR was implemented in the context of the Principles for Financial Market Infrastructures (PFMIs), including CCPs, developed by the Committee on Payment and Settlement Systems (CPSS) and International Organization of Securities Commissions (IOSCO) and published on 16 April 2012⁵.
- 15 Principle 20 relates to FMIs links in general and four of the related Key Considerations (1, 2, 7 and 8) apply to CCP links specifically. For CCPs the PFMIs have identified 4 risks (see Annex 1). EMIR caters for each of those Key Considerations which prescribes that an FMI establishing a link with one or more FMIs should identify, monitor and manage link related risks.
- 16 Few Articles in Title IV Chapter 3 of EMIR refer to interoperability but it is mainly Title V which establishes a regulatory framework for interoperability arrangements between CCPs. In addition to the requirements for interoperability contained in those EMIR Level 1 provisions, ESMA has also issued the Guidelines and Recommendations which were published in March 2013 and applied from 10 June 2013⁶.
- 17 This instrument is composed of five guidelines and recommendations: one related to the legal risk, one related to the open and fair access, one related to the identification,

⁴ http://ec.europa.eu/internal_market/financial-markets/docs/code/code_en.pdf

⁵ <https://www.bis.org/cpmi/publ/d101a.pdf?>

⁶ http://www.esma.europa.eu/system/files/esma_guidelines_recommendations_on_interoperability_arrangements_-_as_approved_by_bos_20130314.pdf

monitoring and management of risks, one related to the deposit of collateral and the final one related to the cooperation between NCAs.

- 18 In its last Questions and Answers document published on 27 April 2015⁷, in CCP question n°21, ESMA addresses the application of the Guidelines and Recommendations 3(b)(v) on prohibition for interoperable CCPs to contribute to their default fund together with the need for them to cover credit and liquidity risk. It specifies that it is not necessary for a CCP to include its credit exposures to the interoperable CCPs when sizing the default fund and other financial resources. However, in that case, it will need to have other arrangements (such as additional margin) in place in order to meet Guideline and Recommendation 3(b)(i) which requires 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.
- 19 All EMIR items on interoperability mentioned herein above focus on risk, their aim is to ensure that any extra or different risk arising from interoperability arrangements compared to a stand-alone CCP are catered for. Logically risk is thus the only relevant reason to refuse access to interoperability arrangements or terminate an existing interoperability arrangement.
- 20 Finally it is worth noting that for ETDs MiFIR requires that, in the case of request for access from a trading venue to a CCP or vice-versa, the competent authority of the trading venue or that of the CCP grants access only where such access would not require an interoperability arrangement⁸ that has not already been agreed on and where the inter-CCP risk is covered. For OTC derivatives, subject to the clearing obligation, EMIR foresees that, in case a CCP request access to trade feed from a trading venue access should be granted only where such access would not require interoperability⁹. These restrictions to access in MiFIR are compatible with the current EMIR framework that covers interoperability for securities only.

⁷ http://www.esma.europa.eu/system/files/2015_775_qa_xii_on_emir_implementation_april_2015.pdf

⁸ Regulation (EU) no 600/2014 of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and amending Regulation (EU) No 648/2012, Article 35 and 36. <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0600&from=EN>

⁹ EMIR Article 8.

3.2 Current existing interoperability arrangements in the EU

3.2.1 EU equities

22 Numerous access requests were exchanged between market infrastructures following the issue and signature of the Code of Conduct and few links became operational especially for newly created MTFs at the time. The links have slowly developed since then and the current interoperability links between CCPs for equities markets are as follows:

MARKETS	BATS Chi-X	Burgundy	AquisExchange	LSE ¹⁰	Turquoise	UBS MTF	Equiduct	Oslo Børs / Oslo Axess
INTEROPERABLE CCPS	EuroCCP NV SIX x-Clear LCH.Clearnet Ltd	EuroCCP NV SIX x-Clear	EuroCCP NV SIX x-clear LCH.Clearnet Ltd	EuroCCP NV ¹¹ SIX x-clear LCH.Clearnet Ltd	EuroCCP N.V. SIX x-clear ¹² LCH.Clearnet Ltd	EuroCCP NV SIX x-clear	EuroCCP NV ¹³ SIX x-clear LCH.Clearnet Ltd	LCH.Clearnet Ltd Oslo Clearing

23 All the above mentioned interoperable links were in place before EMIR was published apart from the one for Aquis exchange since this exchange was created in October 2012 (the corresponding CCPs were already interoperable on other exchanges) and for Oslo Børs/Oslo Axess which went live in 2014 but for which a Memorandum of Understanding had been signed between LCH.Clearnet Ltd and Oslo Clearing back in 2009.

24 As foreseen in Article 54 of EMIR those links and the corresponding arrangements were approved by the relevant national competent authorities at the time each relevant EU CCP was authorised and thus deemed compliant with EMIR. It is anticipated that, following the EFTA and EC agreement, EEA countries will soon transpose EMIR and Oslo Clearing and SIX x-clear will be subject to the corresponding provisions.

¹⁰ SETS and SETSqx order books.

¹¹ subject to regulatory approval, expected to take place in March 2015.

¹² with the exception of Spanish, US and ETF instruments which remain cleared by EuroCCP only.

¹³ for UK, Italian, German, Swiss and Nordic instruments.

3.2.2 EU government bonds: LCH.Clearnet SA – Cassa Di Compensazione e Garanzia

- 25 Only one interoperability scheme has been identified in the EU for government bonds. It is between LCH.Clearnet SA and Cassa di Compensazione e Garanzia (CC&G). It was designed, even before the Code of Conduct, in 2002 and activated in August 2004. The link between LCH.Clearnet SA and CC&G covers the clearing of outright transactions and repos on Italian government bonds traded on MTS Cash and MTS Repo platforms and BrokerTec-ICAP. Both CCPs are part now of the London Stock Exchange Group.
- 26 For the implementation of the link, the two CCPs have a special status in their access rules to each other's system, which is different from that of the ordinary clearing members.
- 27 As foreseen in Article 54 of EMIR those links and the corresponding arrangements were approved by the relevant national competent authorities at the time LCH.Clearnet SA and CC&G were authorised and thus deemed compliant with EMIR.

3.2.3 EU ETDs: LCH.Clearnet Ltd and Oslo Clearing

- 28 Only one interoperability scheme has been identified for EU (exchange traded) derivatives. LCH.Clearnet Ltd interoperates with Oslo Clearing with regard to index and single Norwegian stock futures and options listed on Oslo Børs and Turquoise in a joint order book since 2013.
- 29 As foreseen in Article 54 of EMIR those links and the corresponding arrangements were approved by the relevant national competent authorities at the time LCH.Clearnet Ltd was authorised and thus deemed compliant with EMIR. For Oslo Clearing it is anticipated that, following the EFTA and EC agreement, EEA countries will soon transpose EMIR and Oslo Clearing will be subject to the corresponding provisions.

4 Extension of Title V of EMIR to (OTC) derivatives

- 30 As described above, the most relevant area where interoperability arrangements emerged is in equities and government bonds and to a lesser extent and only recently in exchange traded derivatives. This might have been one of the reasons for EMIR to concentrate on transferable securities and money-market instruments. The other reason mentioned in Recital 73 of EMIR is that interoperability on derivatives, all the more OTC ones, is more complex, counterparty credit risk plays a more prominent role and thus this required more time to decide on.
- 31 It should be noted that most of the interoperability arrangements date prior to EMIR. There might have been little residual commercial interest in establishing additional ones. Therefore, the extent to which EMIR actually contributed to the development of interoperability arrangement is to be further assessed. On the one hand, EMIR gives a right to CCPs to establish interoperability arrangements on a non-discriminatory basis

and denial can be only based on risk ground. On the other hand, EMIR recognises the risks arising from interoperability arrangements and sets-out a detailed regulatory framework to cope with them. How all these factors have played toward the establishment of new interoperability arrangements is difficult to assess, but the empirical evidence shows that EMIR did not work as a driving force for the creation of new interoperability arrangements.

- 32 Although EMIR does not envisage a specific regime for interoperability arrangements for derivatives, these are not prohibited and, as mentioned above, NCAs already agreed to apply the framework established in the Guidelines and Recommendation to assess the risks arising from interoperability arrangements also when involving derivatives. It should, however, be noted that given that EMIR does not cover interoperability arrangements on derivatives, no specific Guideline or Recommendation was developed for these type of arrangements.

4.1 Reasons for extension

- 33 Articles in EMIR related to interoperability and the Guidelines and Recommendations¹⁴ focus on risks that might arise from interoperability arrangements and the measures to mitigate them. Since the Guidelines and Recommendations already apply to all interoperability arrangements including (OTC) derivatives ones the focus will be here on the extension of EMIR provisions to (OTC) derivatives. Indeed, should EMIR be extended to cover (OTC) derivatives, the Guidelines and Recommendations will be revised to assess whether specific guidelines or recommendations are needed for interoperability arrangements on (OTC) derivatives.
- 34 Concerning fair and open access between CCPs, which is dealt with under Article 51 of EMIR, the aim is to ensure that future expansion of the interoperability arrangement to other CCPs is not restricted other than on risk grounds. This is a general principle agreed at international level for the establishment of links. However, it also provides a legal access right on the CCP requesting the establishment of the interoperability arrangements. Therefore it incentivises their establishment. The reasons for extending this provision is further assessed below.
- 35 Risk management is the topic covered in Article 52 of EMIR which is critical for ensuring the prudent management of the interoperability arrangement to guarantee the safety of all interoperable CCPs. The main drivers of this provision are: a) ensuring that the interoperability arrangement does not expose the relevant CCPs to additional risks that are not appropriately mitigated; b) ensuring 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.

¹⁴ http://www.esma.europa.eu/system/files/esma_guidelines_recommendations_on_interoperability_arrangements_-_as_approved_by_bos_20130314.pdf

- 36 The scope of Article 52 of EMIR encompasses the legal risk arising from the interoperability arrangements to ensure a coherent and enforceable legal and procedural framework identifying the rights and obligations of the relevant CCPs and the process and procedures to be followed for the proper functioning of the arrangement.
- 37 Whilst one would agree that risks pertaining to transferable securities and money market instruments are different from risks stemming from (OTC) derivatives, the main drivers and the content of Article 52 of EMIR, cross-referred to in the Guidelines and Recommendations 1 and 3, are high level and thus applicable to all financial instruments so again there is no strong justification for limiting this provision to transferable securities.
- 38 The objective of Article 53 of EMIR on provision of margin among CCPs is to ensure the timely availability of collateral in all circumstances, including the default of an interoperable CCP.
- 39 This is not specific to any type of financial instruments and relates to the arrangements and applicable laws between the relevant CCPs, it is also cross-referred to in the Guideline and Recommendation 4 which applies already to (OTC) derivatives. Thus Article 53 of EMIR should be extended to interoperability on (OTC) derivatives.
- 40 Article 54 of EMIR focuses on the approval of interoperability arrangement between the relevant CCPs by the relevant authorities and the procedures for such an approval. It refers to the conditions for the approval which relate to the fact that the relevant CCPs should be authorised or recognised, that the requirements laid down in Article 52 of EMIR on risk management should be met and that the arrangement should be sound and not undermine effective supervision.
- 41 Article 54 of EMIR is cross-referred to in the Guideline and Recommendation 5 which applies already to (OTC) derivatives. Besides the procedure and general conditions for approval together with the need for effective supervision are not specific to any type of financial instruments, the corresponding EMIR provision should be thus extended to interoperability on (OTC) derivatives.

4.2 Cost and benefit analysis of extension

- 42 The impact assessment of EMIR¹⁵ including Title V has already been performed. Besides Annex II of the Final Report¹⁶ on the Guidelines and Recommendations contains the cost-benefit analysis for the Guidelines and Recommendations on choices or options on (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

¹⁵ <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52010SC1058&from=EN>

¹⁶ http://www.esma.europa.eu/system/files/2013-323_annex_1_esma_final_report_on_guidelines_on_interoperability.pdf

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.

- 43 The above mentioned documents do not make any specific reference or difference in the assessment of the (qualitative) costs and benefits depending on the financial instruments. The analysis and the conclusion are thus applicable to (OTC) derivatives as much as they are to transferable securities or money-market instruments. Furthermore the Guidelines and Recommendations which cross-refer all EMIR provisions included in Title V which is dedicated to interoperability are already applicable to (OTC) derivatives. in case interoperability arrangements are established.
- 44 Having in mind that currently there is only one interoperability arrangement on derivatives in the EU, the extra work for regulators or CCPs to ensure compliance with further regulation to those arrangements do not constitute a relevant argument to avoid extension.
- 45 Finally it is worth noting that the rationale for EMIR and MIFIR provisions on interoperability in the context of request for access from trading venues to CCPs or vice versa regarding (OTC) derivatives described in paragraph 20, is not to restrict the use of interoperability for (OTC) derivatives but rather to strike the right balance between the right to access trade feed or clearing services with the significant effort represented by the set-up of an interoperability link.
- 46 Therefore the remaining question is simply whether interoperability arrangements for derivatives should be incentivised via the access provisions of Article 51 of EMIR. In this respect, it is worth distinguishing between OTC derivatives and ETD derivatives.
- 47 For OTC derivatives, the complexities involved and the potential effect of the clearing obligation seems to introduce a sufficient degree of uncertainty and therefore potential significant costs linked to the extensions, with limited benefit as proven by the uncertain effect in terms of incentives that EMIR involved.
- 48 For ETDs, one interoperability arrangement already exists. The complexity is certainly lower than for OTC derivatives and the general framework for assessing the risk involved with these arrangements is already in place. Therefore, the costs for extending the EMIR provisions on interoperability to ETD are relatively small. The benefits in terms of incentives are uncertain, but the benefit in terms of certainty on the right of establishment an interoperability arrangement for derivatives will be undisputed. One additional benefit could be for ESMA to revisit the Guidelines and Recommendations to check whether specific Guidelines or Recommendations are needed for interoperability arrangement for derivatives. Therefore, the potential benefits overcome the potential costs for the extension.

5 Conclusion

- 49 At the time of EMIR publication the focus was on transferable securities and money-market instruments interoperability arrangement since those were the vast majority (if not all) existing arrangements then. However the need for a framework for (OTC) derivatives was already acknowledged and catered for by the global scope of the Guidelines and Recommendations.
- 50 The provisions ruling interoperability in EMIR are focussed on risk. They are high level without going into the specificity of the products covered by the interoperability arrangements. They thus raise the same costs and benefits if they are extended to (OTC) derivatives.
- 51 With reference to potential extension of the EMIR provisions to interoperability arrangement on derivatives, a distinction should be made between OTC derivatives and ETD.
- 52 For OTC derivatives certainly the additional complexities involved in an interoperability arrangement mentioned by recital 73 are still present. In addition, the clearing of these instruments is relatively new and it is growing. Furthermore, the effects of the clearing obligation will still need to be assessed in terms of higher risks for CCPs. Therefore, the reasons for which at the time EMIR was drafted the interoperability framework was restricted to transferable securities still applies in the case of OTC derivatives.
- 53 For ETD, as highlighted in the cost-benefit analysis section of this report, the potential benefits of the extension overcome the potential costs. Therefore ESMA recommends extending the EMIR provision related to interoperability arrangements to ETD only. A further extension to OTC Derivatives should be assessed at a later stage.
- 54 The extension of the interoperability arrangements in EMIR to ETD, would no longer justify the restriction in MiFIR on the provisions to access, as described in paragraph 20, which should therefore be amended accordingly.



Annex 1

PFMI RISK FOR CCP LINKS	CORRESPONDING EMIR PROVISIONS (LEVEL 1 and 2)	CORRESPONDING GUIDELINE AND RECOMMANDATION
<p><u>Risk 1:</u> Before entering into a link arrangement and on an ongoing basis once the link is established, an FMI should identify, monitor, and manage all potential sources of risk arising from the link arrangement. Link arrangements should be designed such that each FMI is able to observe the other principles in this report.</p>	<p><u>EMIR Art 52(1):</u> CCPs that enter into an interoperability arrangement shall:</p> <ul style="list-style-type: none"> (a) put in place adequate policies, procedures and systems to effectively identify, monitor and manage the risks arising from the arrangement so that they can meet their obligations in a timely manner; (b) agree on their respective rights and obligations, including the applicable law governing their relationships; (c) identify, monitor and effectively manage credit and liquidity risks so that a default of a clearing member of one CCP does not affect an interoperable CCP; (d) identify, monitor and address potential interdependences and correlations that arise from an interoperability arrangement that may affect credit and liquidity risks relating to clearing member concentrations, and pooled financial resources. <p>For the purposes of point (b) of the first subparagraph, CCPs shall use the same rules concerning the moment of entry of transfer orders into their respective systems and the moment of irrevocability as set out in Directive 98/26/EC, where relevant.</p> <p>For the purposes of point (c) of the first subparagraph, the terms of the arrangement shall outline the process for managing the consequences of the default where one of the CCPs with which an interoperability arrangement has been concluded is in default.</p> <p>For the purposes of point (d) of the first subparagraph, CCPs shall have robust controls over the re-use of clearing members' collateral under the arrangement, if permitted by their competent authorities. The arrangement shall outline how those risks have been addressed taking into account sufficient coverage and need to limit contagion.</p>	<p><u>ESMA Guideline and Recommendation 1:</u> 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.</p> <p><u>ESMA Guideline and Recommendation 3:</u> 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.</p> <p><i>Detailed Guidelines and Recommendations</i></p> <p>a) General policies, procedures and systems</p> <p>In applying general Guideline and Recommendation 3, NCAs should at least take into account the following:</p> <ul style="list-style-type: none"> 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.



<p><u>Risk 2:</u> a link should have a well-founded legal basis, in all relevant jurisdictions, that supports its design and provides adequate protection to the FMIs involved in the link.</p>	<p><u>EMIR Art 52(1):</u> CCPs that enter into an interoperability arrangement shall:</p> <ul style="list-style-type: none"> (a) put in place adequate policies, procedures and systems to effectively identify, monitor and manage the risks arising from the arrangement so that they can meet their obligations in a timely manner; (b) agree on their respective rights and obligations, including the applicable law governing their relationships; (c) identify, monitor and effectively manage credit and liquidity risks so that a default of a clearing member of one CCP does not affect an interoperable CCP; (d) identify, monitor and address potential interdependences and correlations that arise from an interoperability arrangement that may affect credit and liquidity risks relating to clearing member concentrations, and pooled financial resources. <p>For the purposes of point (b) of the first subparagraph, CCPs shall use the same rules concerning the moment of entry of transfer orders into their respective systems and the moment of irrevocability as set out in Directive 98/26/EC, where relevant.</p> <p>For the purposes of point (c) of the first subparagraph, the terms of the arrangement shall outline the process for managing the consequences of the default where one of the CCPs with which an interoperability arrangement has been concluded is in default.</p> <p>For the purposes of point (d) of the first subparagraph, CCPs shall have robust controls over the re-use of clearing members' collateral under the arrangement, if permitted by their competent authorities. The arrangement shall outline how those risks have been addressed taking into account sufficient coverage and need to limit contagion.</p>	<p><u>ESMA Guideline and Recommendation 1:</u></p> <p>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.</p> <p><i>Detailed Guidelines and Recommendations</i></p> <p>b) Legal analysis</p> <p>When applying general Guideline and Recommendation 1, NCAs should at least take into account the following:</p> <ul style="list-style-type: none"> 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.
<p><u>Risk 3:</u> Before entering into a link with another CCP, a CCP should identify and manage the</p>	<p><u>EMIR Art 52(1):</u></p>	<p><u>ESMA Guideline and Recommendation 3:</u></p>

<p>potential spill-over effects from the default of the linked CCP. If a link has three or more CCPs, each CCP should identify, assess, and manage the risks of the collective link arrangement.</p>	<p>CCPs that enter into an interoperability arrangement shall:</p> <ul style="list-style-type: none"> (a) put in place adequate policies, procedures and systems to effectively identify, monitor and manage the risks arising from the arrangement so that they can meet their obligations in a timely manner; (b) agree on their respective rights and obligations, including the applicable law governing their relationships; (c) identify, monitor and effectively manage credit and liquidity risks so that a default of a clearing member of one CCP does not affect an interoperable CCP; (d) identify, monitor and address potential interdependences and correlations that arise from an interoperability arrangement that may affect credit and liquidity risks relating to clearing member concentrations, and pooled financial resources. <p>For the purposes of point (b) of the first subparagraph, CCPs shall use the same rules concerning the moment of entry of transfer orders into their respective systems and the moment of irrevocability as set out in Directive 98/26/EC, where relevant.</p> <p>For the purposes of point (c) of the first subparagraph, the terms of the arrangement shall outline the process for managing the consequences of the default where one of the CCPs with which an interoperability arrangement has been concluded is in default.</p> <p>For the purposes of point (d) of the first subparagraph, CCPs shall have robust controls over the re-use of clearing members' collateral under the arrangement, if permitted by their competent authorities. The arrangement shall outline how those risks have been addressed taking into account sufficient coverage and need to limit contagion.</p>	<p>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.</p> <p><i>Detailed Guidelines and Recommendations</i></p> <p>In applying general Guideline and Recommendation 3, NCAs should at least take into account the following:</p> <ul style="list-style-type: none"> 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. 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. <p>ESMA Guideline and Recommendation 4:</p> <p>A NCA should assess that an interoperable CCP deposits collateral in a way that it is protected from the default of any interoperable CCPs.</p>
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Risk 4: Each CCP in a CCP link arrangement should be able to cover, at least on a daily basis, its current and potential future exposures to the linked CCP and its participants, if any, fully with a high degree of confidence without reducing the CCP's ability to fulfil its obligations to its own participants at any time.

EMIR Art 40:

A CCP shall measure and assess its liquidity and credit exposures to each clearing member and, where relevant, to another CCP with which it has concluded an interoperability arrangement, on a near to real-time basis. A CCP shall have access in a timely manner and on a non-discriminatory basis to the relevant pricing sources to effectively measure its exposures. This shall be done on a reasonable cost basis.

EMIR Art 41(1):

A CCP shall impose, call and collect margins to limit its credit exposures from its clearing members and, where relevant, from CCPs with which it has interoperability arrangements. Such margins shall be sufficient to cover potential exposures that the CCP estimates will occur until the liquidation of the relevant positions. They shall also be sufficient to cover losses that result from at least 99 % of the exposures movements over an appropriate time horizon and they shall ensure that a CCP fully collateralises its exposures with all its clearing members, and, where relevant, with CCPs with which it has interoperability arrangements, at least on a daily basis. A CCP shall regularly monitor and, if necessary, revise the level of its margins to reflect current market conditions taking into account any potentially procyclical effects of such revisions.

EMIR Art 41(2):

A CCP shall adopt models and parameters in setting its margin requirements that capture the risk characteristics of the products cleared and take into account the interval between margin collections, market liquidity and the possibility of changes over the duration of the transaction. The models and parameters shall be validated by the competent authority and subject to an opinion in accordance with Article 19.

EMIR Art 41(3):

A CCP shall call and collect margins on an intraday basis, at least when pre-defined thresholds are exceeded.

EMIR Art 41(4):

A CCP shall call and collect margins that are adequate to cover the risk stemming from the positions registered in each account kept in accordance with Article 39 with respect to specific financial instruments. A CCP may calculate margins with respect to a portfolio of financial instruments provided that the methodology used is prudent and robust.

EMIR Art 52(1):

CCPs that enter into an interoperability arrangement shall:

ESMA Guideline and Recommendation 4:

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

- (a) put in place adequate policies, procedures and systems to effectively identify, monitor and manage the risks arising from the arrangement so that they can meet their obligations in a timely manner;
- (b) agree on their respective rights and obligations, including the applicable law governing their relationships;
- (c) identify, monitor and effectively manage credit and liquidity risks so that a default of a clearing member of one CCP does not affect an interoperable CCP;
- (d) identify, monitor and address potential interdependences and correlations that arise from an interoperability arrangement that may affect credit and liquidity risks relating to clearing member concentrations, and pooled financial resources.

For the purposes of point (b) of the first subparagraph, CCPs shall use the same rules concerning the moment of entry of transfer orders into their respective systems and the moment of irrevocability as set out in Directive 98/26/EC, where relevant.

For the purposes of point (c) of the first subparagraph, the terms of the arrangement shall outline the process for managing the consequences of the default where one of the CCPs with which an interoperability arrangement has been concluded is in default.

For the purposes of point (d) of the first subparagraph, CCPs shall have robust controls over the re-use of clearing members' collateral under the arrangement, if permitted by their competent authorities. The arrangement shall outline how those risks have been addressed taking into account sufficient coverage and need to limit contagion.

EMIR Art 52(2):

Where the risk-management models used by the CCPs to cover their exposure to their clearing members or their reciprocal exposures are different, the CCPs shall identify those differences, assess risks that may arise therefrom and take measures, including securing additional financial resources, that limit their impact on the interoperability arrangement as well as their potential consequences in terms of contagion risks and ensure that these differences do not affect each CCP's ability to manage the consequences of the default of a clearing member.

RTS on CCP Requirements Art 24(1):

A CCP shall calculate the initial margins to cover the exposures arising from market movements for each financial instrument that is collateralized on a product basis, over the time period defined in Article 25 and assuming a time horizon for the liquidation of the position as defined in Article 26. For the calculation of initial margins the CCP

	<p>shall at least respect the following confidence intervals:</p> <p>(a) for OTC derivatives, 99.5%;</p> <p>(b) for financial instruments other than OTC derivatives, 99%.</p> <p><u>RTS on CCP Requirements Art 24(2):</u></p> <p>For the determination of the adequate confidence interval for each class of financial instruments it clears, a CCP shall in addition consider at least the following factors:</p> <p>(a) the complexities and level of pricing uncertainties of the class of financial instruments which may limit the validation of the calculation of initial and variation margin;</p> <p>(b) the risk characteristics of the class of financial instruments, which can include, but are not limited to, volatility, duration, liquidity, non-linear price characteristics, jump to default risk and wrong way risk;</p> <p>(c) the degree to which other risk controls do not adequately limit credit exposures;</p> <p>(d) the inherent leverage of the class of financial instruments, including whether the class of financial instrument is significantly volatile, is highly concentrated among a few market players or may be difficult to close out.</p> <p><u>RTS on CCP Requirements Art 24(3):</u></p> <p>The CCP shall inform its competent authority and its clearing members on the criteria considered to determine the percentage applied to the calculation of the margins for each class of financial instruments.</p> <p><u>RTS on CCP Requirements Art 24(4):</u></p> <p>Where a CCP clears OTC derivatives that have the same risk characteristics as derivatives executed on regulated markets or an equivalent third country market, on the basis of an assessment of the risk factors set out in paragraph 2, the CCP may use an alternative confidence interval of at least 99% for those contracts if the risks of OTC derivatives contracts it clears are appropriately mitigated using such confidence interval and the conditions in paragraph 2 are respected.</p>	
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