NYSE Euronext’s Response to ESMA’s Consultation Paper on Guidelines for establishing consistent, efficient and effective assessments of interoperability arrangements

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1. About NYSE Euronext

NYSE Euronext is a leading global operator of financial markets and a provider of innovative trading technologies. NYSE Euronext’s exchanges in Europe (Amsterdam, Brussels, Lisbon, London and Paris) and the United States provide for the trading of cash equities, bonds, futures, options, and other Exchange-traded products. NYSE Liffe is the name of NYSE Euronext’s European derivatives business and is the world’s second largest derivatives business by value of trading. It includes LIFFE Administration and Management, which is a self-clearing Recognised Investment Exchange pursuant to the UK Financial Services and Markets Act 2000 and, as such, is the central counterparty (“CCP”) to transactions on NYSE Liffe’s derivatives market in London.

2. General comments

NYSE Euronext believes it crucial to ensure authorities receive all necessary information to accurately assess interoperability arrangements for the purpose of the European Market Infrastructure Regulation, and as such welcomes ESMA’s guidelines.

However, NYSE Euronext believes it important to highlight that, as suggested in EMIR, interoperability arrangements should be entered into by central counterparties on a voluntary basis, and not to be mandated. Contrary to the European Commission’s claims in the context of the review of the Markets in Financial Instruments Directive, the positive effects of mandating interoperability or open access are purely speculative, whilst the associated risks are significant.

First, mandating interoperability between CCPs will not materially reduce the existing level of the costs of cross-border trading in Europe given the inevitable need for substantial investments in additional processes and legal documentation. In any cases, the reduction in post trade costs of transactions would only accrue to large members who clear on several CCPs and have the necessary resources for the technological investment needed to multiply their connections (and nothing would ensure that these cost reductions would be passed on to end investors). Small members who clear in a single CCP, as well
as a majority of market participants who clear their trades through a large member, would not benefit from any direct cost reduction. In addition, mandated interoperability will place many smaller CCPs under untenable pressure and run the risk of forcing them to compete by lowering their risk standard process to a minimum. Indeed, forced interoperability is likely to lead to a consolidation of cleared volumes into a smaller number of larger CCPs, placing the business models of smaller CCPs under pressure. We believe it important that competent authorities take the impact of this ‘corporate risk’ into account when considering interoperability requests: if a smaller CCP is facing issues as a going concern, then this may result in lower operational capacities and less rigorous risk management.

Furthermore, as suggested in EMIR and contrary to the European Commission’s proposals in the context of the review of MiFID, NYSE Euronext believes that it would be premature for any forthcoming legislation to include substantive provisions in relation to derivatives clearing interoperability due to the related significant legal and operational issues. In fact, derivatives clearing interoperability has the potential to raise significant additional systemic risks which have not yet been fully assessed. As such, the interoperability framework contained in Title V of EMIR Level 1 is rightly restricted to transferable securities and money market instruments. It would be crucial to ensure that any framework or requirements in respect to interoperability or open access for derivatives clearing is adopted only after ESMA’s mandated report to the European Commission (which should be issued by 30 September 2014), on whether it would be appropriate to extend the scope of the interoperability framework to other asset classes.

Finally, NYSE Euronext believes it important to bear in mind that interoperability, whether mandated or entered into on a voluntary basis, would not only increase the costs borne by CCPs, but also by national regulators and public authorities. ESMA’s suggested guidelines should therefore take into consideration the need for a balance between, on one hand, the need to ensure that competent authorities are provided with the necessary elements to assess interoperability arrangements and the additional costs that any detailed requirements in this respect imply for these authorities and CCPs. As they stand, the drafted guidelines require a lot of documentation, legal assessments and due diligence to approve or reject an interoperability request, and will therefore result in important costs both for CCPs and regulators, and the question arises so as to who is going to pay for these costs.

3. Responses

Q1: Do you think that the draft guidelines adequately capture all the relevant considerations for an NCA when receiving an application from a CCP to establish an interoperability arrangement?

NYSE Euronext believes that a critical aspect that NCAs should consider when assessing interoperability arrangements that does not appear in the suggested guidelines relates to how buy-in procures will be effected by each CCP willing to enter into an interoperability arrangements. NYSE Euronext considers that any application from a CCP to establish an interoperability arrangement should describe whether members will be subject only to their CCP’s buy-in rules or if buy-in rules will be harmonised across the
CCPs willing to become interoperable and how the CCPs will administer buy-ins between them. Such provision in respect to the information required on buy-in procedures should be included in Guideline 3.

Q2: 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.

NYSE Euronext considers that certain areas of the guidelines would need to be further detailed, as outlined in the paragraphs below.

**Guideline 1. Legal risk**

- **a) Documentation**

NYSE Euronext believes it important to ensure that an analysis is provided to the regulators, members and Risk Committee of both CCPs, that clearly identifies if and where interoperable arrangement have an impact on the risks to which each of the CCP is exposed. This is the basis to take a conscious decision about the risk-reward profile of any arrangements plus it is the basis to identify which risk mitigating processes /tools /measures have to be put in place.

In addition, considering that establishing processes is not sufficient if the base challenge is not understood, NCAs, members and Risk Committees should receive adequate documentation clearly describing the technical and operational process and information flow including all interfaces and timings, in order for them to assess the additional operational complexity /dependencies and risk arising from the intended interoperability links.

Finally, documentation describing the settlement and re-alignment process for cross-CCP trades should be provided in order to make all operational complexity drivers transparent.

- **b) Legal analysis**

NYSE Euronext considers that the fact that the guidelines only require the CCP to conduct adequate due diligence to ensure there is a high degree of certainty regarding the enforceability of its default rules against the interoperable CCPs and regarding the viability of its interoperability procedures should be questioned. ESMA should consider whether this “high degree” of certainty needs to be quantified and if the CCP has to put in place additional guarantees /collateral /LOC in the legal & regulatory environment of the interoperable CCP to reduce any remaining uncertainty.

**Guideline 2. Open and fair access**

NYSE Euronext considers that, similarly to the world of CSDs (where CSD links have to be assessed, approved and re-assessed from time to time by the relevant National Central Banks), CCP links should also be subject to an initial approval process, and reviewed on a regular basis by NCAs. This is even
more important since the risk within CSD links is “only” settlement risk, while the risk profile of CCP links is much more complex.

Guideline 3. Identification, monitoring and management of risks

NYSE Euronext believes it crucial for competent authorities to be communicated all the information relative to the assessment of the potential impact, at each CCP’s level, in terms of operational risk, of the corporate risks raised by the interoperability arrangements. In fact, interoperability arrangements may result in a concentration which could ultimately threaten the operational capacities of the smallest CCPs engaged in these arrangements. This is because interoperability arrangements may incentivise large members, who clear on several CCPs, to concentrate in one CCP (the largest). Smaller CCPs will clear less business, with lower revenues, which could ultimately lead them to have lower operational capacities, and hence increase operational risk.

Guideline 4. Deposit of collateral

NYSE Euronext believes it crucial to specify that CCPs should be required to ensure that the collateral (i) will be available exclusively and (ii) can be liquidated in a timely manner when needed, by using either pledge or title-transfer, depending on the legal environment.

Guideline 5. Cooperation between NCAs

NYSE Euronext is concerned by the current draft for the Guidelines 5 paragraph 1: as it stands this paragraph may force CCPs to share some of their trade secrets and IP rights, considering that, to some extent, the risk management approach, the data used, the algorithms and the off-sets granted can be considered as the IP and/or trade secret of CCPs. Therefore, NYSE Euronext would recommend ESMA to specify how IP rights and trade secrets of CCPs will be protected under the suggested information sharing and cooperation arrangements between NCAs.

Q3: Is it appropriate to consider an assessment by CCPs of the membership criteria of interoperable CCPs?

Yes, NYSE Euronext believes that it is crucial for membership criteria to be assessed as these are the ‘first line of defence’ in the default waterfall of any CCP. In their respect, it may be necessary to require CCPs willing to become interoperable to assess the need for the alignment of their membership criteria, and to provide NCAs with this assessment, and when the decision was not to align these criteria, with an explanation of the reasons why membership conditions were not aligned. In addition, special care should be given to the assessment of the concentration risk that any interoperability arrangements may contribute to increase. Furthermore, the ongoing monitoring of the creditworthiness of existing members should also be required.
Q4: Do you have additional comments on the draft guidelines?

No, NYSE Euronext does not have additional comments on the draft guidelines.

4. Contacts

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