Dear Sirs,

AIMA’s response to Consultation Paper, ‘Guidelines for establishing consistent, efficient and effective assessments of interoperability arrangements’ (ESMA/2012/852)

The Alternative Investment Management Association Limited (AIMA) welcomes the opportunity to respond to the consultation paper, ‘Guidelines for establishing consistent, efficient and effective assessments of interoperability arrangements’ (Consultation Paper).

AIMA acknowledges the potential benefits to its members of central counterparty interoperability. AIMA recognises that the establishment of effective interoperability arrangements between central counterparties (CCPs) ensures that end-users of financial instruments eligible for clearing are able to trade such instruments freely, regardless of the particular CCP through which such end-users may clear their trades. Notwithstanding this potential benefit, it is critical to AIMA that the cooperation implicit in any interoperability arrangement does not hinder competition between CCPs on matters such as price and quality of service. It is also critical that interoperability arrangements effectively identify, monitor, assess, manage and mitigate any risks which may arise between the relevant CCPs. This is AIMA’s principal concern and it is in respect of this that we provide our response to the Consultation Paper.

AIMA’s comments on the proposed guidelines

AIMA broadly agrees that the draft guidelines proposed in the Consultation Paper capture the relevant key considerations for a national competent authority (NCA) when receiving an application from a CCP to establish an interoperability arrangement. However, we would request that the European Securities and Markets Authority (ESMA) consider several amendments to Guideline 1 (Legal risk) and Guideline 3 (Identification, monitoring and management of risks) as proposed in the Consultation Paper.

The systemic importance of CCPs lies in the extent to which the default of a CCP has the capacity to spread across the clearing system to other market participants. This is a direct consequence of the concentration of risk necessitated by a requirement to centrally clear ‘eligible’ transactions. The European Markets Infrastructure Regulation (EMIR) recognises such systemic importance in its regulation of CCPs on matters such as CCP authorization, CCP ownership limits and CCP requirements as to segregation and portability of margin and positions in respect of cleared trades.

The default risk of a CCP is of an even greater concern in the context of interoperability arrangements. By definition, interoperability is an arrangement which creates financial exposures between CCPs. Where an interoperating CCP defaults, the potential losses incurred by the relevant CCP with which it interoperates, are likely to exceed total margin contributions and a CCP’s own capital. Further, evidence indicates that

1 AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector – including hedge fund managers, fund of hedge fund managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,300 corporate bodies in over 40 countries.
undercollateralisation of cross-CCP exposures is a valid concern with respect to interoperability arrangements. In short, AIMA’s position is that CCP interoperability arrangements have particular risk management concerns which could potentially outweigh those in respect of clearing members, direct clients and indirect clients. Therefore, AIMA respectfully requests that ESMA recognise this in the draft guidelines in a manner which is consistent with the spirit of EMIR, specifically Article 28(3), which states that the “…risk committee shall advise the board on any arrangements that may impact the risk management of the CCP”. In particular, we request that the guidelines emphasise the importance of risk committee consultation in all circumstances where the establishment of, or any change to, an interoperability arrangement occurs. Such increased emphasis can be achieved with the following amendments to the draft guidelines:

i. Amendments to paragraph (a), Guideline 1 (Legal risk)

“a. Documentation

That the documentation governing the interoperability arrangement:

[...]

iv. Establishes a process to inform and consult the risk committee and the clearing members at all times where the establishment of, or any change to, the interoperable arrangement occurs 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.”

ii. Amendments to paragraph (a), Guideline 3 (Identification, monitoring and management of risks)

“Detailed guidelines

2. In applying the general guideline NCAs should at least take into account the following:

[...]

vii. That there is a process for the regular review of the CCP’s risk management framework for identifying, monitoring, assessing and mitigating risks arising from the interoperability arrangement, including interdependencies or spillover effects. There should also be a process for the interoperable CCPs to assess the need for harmonisation of their respective risk management frameworks. Such processes should be approved by the boards of the CCPs with the prior consultation of the CCP risk committee.”

Additional AIMA comments on the proposed guidelines

AIMA supports the objective of the proposed guidelines to improve the rigor of standards applied by NCAs in their assessment of interoperability arrangements. On this basis alone, we believe it is entirely appropriate to consider an assessment by CCPs of the membership criteria of interoperable CCPs.

AIMA also supports the objective of the proposed guidelines to improve the uniformity of standards applied by NCAs in their assessment of interoperability arrangements. However, it is AIMA’s position that NCAs are more likely to apply standards in their assessment of interoperability arrangements in a uniform manner where there is consistency between the EMIR level 1 text and the level 3 guidance. The amendments proposed above seek to address any inconsistencies in the underlying regulation.

Finally, AIMA applauds ESMA’s recognition that, in helping define what NCAs should look at in assessing an interoperability arrangement, the guidelines define the key aspects of interoperability arrangements CCPs should focus their attention on. However, it is AIMA’s position that without an appropriate level of consultation with its risk committee, a CCP will fail to fully consider the key risks arising under an interoperability arrangement. The amendments proposed above seek to address this point.

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Please let us know if you would like to discuss any of the above comments in more detail. AIMA is also keen to assist ESMA in any way it can with its report to the European Commission on whether it would be appropriate to extend the scope of EMIR requirements in respect of interoperability arrangements to other financial instruments, such as OTC derivatives.¹

Yours faithfully,

Jiří Król
Director of Government & Regulatory Affairs

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