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European Securities and Markets Authority

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EuroCCP responses to ESMA's Consultation Paper – Guidelines for establishing consistent, efficient and effective assessments of interoperability arrangements required under Article 54(4) of Regulation (EU) No 648/2012 dated 20th December 2012 (the "Consultation Paper")

European Central Counterparty Limited ("EuroCCP") would like to thank the European Securities and Markets Authority ("ESMA") for providing this opportunity for industry participants to comment on the proposals set out in the Consultation Paper. EuroCCP is pleased to offer its views based both on its general experience as a UK Recognised Clearing House providing cash equities clearing services across 17 European markets and its specific experience of managing multiple interoperating arrangements with a number of other cash equities CCPs over the last 12 months. In this respect, EuroCCP currently operates interoperable links with LCH. Clearnet Limited, SIX x-clear AG and EMCF N.V on a number of trading venues including BATS Chi X and Turquoise.

EuroCCP welcomes and supports the adoption of guidelines to assist National Competent Authorities ("NCA") in their assessment of interoperability arrangements both in terms of improving the uniformity of standards and in providing a robust framework for CCPs to use when considering the risks arising from creating such arrangements. In this respect, EuroCCP believes that the adoption of common interoperating principles by the UK, Dutch and Swiss central banks and securities regulators involved in approving four way interoperability on the BATs Chi X trading venue in 2011 greatly assisted the process of establishing robust inter CCP frameworks to identify, address and mitigate risks arising in those link arrangements.

As a general matter, we believe the draft guidelines are comprehensive and proportionate and reflective of principles and frameworks which are already being applied to existing interoperating arrangements. We do, however, believe that in certain respects the draft guidelines require some refinement and we have commented on those aspects of the guidelines below.

Guideline 1. Legal Risk

General Guideline

This Guideline references the need for interoperability arrangements to be transparent but does not articulate to whom. We believe that all aspects of the arrangement should be transparent to all other CCPs that interoperate with any of the CCPs subject to the arrangement being reviewed, to all relevant regulators, and to clearing participants of the of the CCPs subject to the arrangement. This principle should include any changes to interoperable arrangements agreed between pairs of CCPs likely to have a material impact on the risks to which any other CCP which interoperates with that pair of CCPs is party to.

Guideline 3. Identification, monitoring and management of risks

Detailed Guideline 2 a) ii)

This guideline requires the NCA to take into account whether “the CCP has comprehensive information on the operations of the interoperating CCPs, including the potential reliance on third parties as critical service providers” when assessing whether a CCP has met the general guideline to put “in place a general framework to identify, monitor and manage the potential risks arising from the interoperability arrangement”.

We do not believe that imposing this form of obligation on a CCP is practical or would materially add to information that the NCA or relevant college of supervisors would already have access to or could directly request from the applicable interoperating CCP. We believe that a CCP would be highly likely to consider the “comprehensive” disclosure of this type of operational information as commercially sensitive and confidential. Accordingly, we do not believe that such disclosure would or could be made to an interoperating CCP with which the disclosing CCP was in active completion with. In addition, it seems unlikely that any information that was made available in that process would enable a CCP to make a material assessment of the operational capability of another CCP particularly given differences in technology and methodologies employed by each applicable CCP.

We believe that it will be evident whether a CCP is operationally competent to enter into an interoperable arrangement by reference to its current clearing activities, its regulatory status and from its approach to putting in place applicable inter-CCP operational procedures and business continuity arrangements with trade venues. In this respect, EMIR and associated technical standards already require CCPs to comply with extensive business continuity requirements including the identification and continuity of all critical business functions. We also note the existing

requirement under Article 54 of EMIR that a CCP that wishes to enter into an interoperability arrangement may only be granted approval by the NCA where the CCPs involved have been authorised to clear under EMIR or a pre-existing national authorisation regime for a period of at least 3 years.

Given the above we do not believe that this proposed guideline is required and should be deleted.

Detailed Guideline 2 a) v)

In general we believe transparency should be employed as far as possible as a risk mitigant, especially in a cluster of interoperating CCPs which includes parties not involved in every bilateral arrangement. As such, we believe this guideline should explicitly include provisions for multi-CCP disclosure.

Detailed Guideline 2 a) vi)

We believe that in a cluster of interoperating CCPs it is very important that any commercial arrangement that is specific to a pair of interoperating CCPs and that may increase risk to other interoperating CCPs is made transparent to all interoperating CCPs in order for that risk to be properly assessed. As such we believe that this guideline should be amended to reflect this principal.

Detailed Guideline 2 a) vii)

We disagree with the assumption set out in this guideline which suggests there should be a process to assess the need for harmonisation of CCP's respective risk management frameworks. For example, an interoperating agreement could require each CCP to provide the other CCP with collateral that the other CCP deems necessary to cover its exposure, using the same methodology as it applies to its clearing members to ensure non-discrimination. Such an arrangement implicitly recognises that the amount of collateral exchanged by the interoperating CCPs would likely be different. Each CCP, in using its own methodology to determine the amount of collateral needed, is satisfied that it does not need to compromise its risk management framework to accommodate the other. Therefore, we do not believe that risk management frameworks need to be harmonised to enable interoperating arrangements to function well.

We also believe that there is a need to avoid convergence risk where all CCPs risk being "wrong" in their risk management approach in the same way which might arise if risk management frameworks were harmonised. Risk management harmonisation might also contribute to a lack of due diligence on the part of CCPs if the overall principle was established that each CCP risk management framework should simply mirror that of each other interoperating CCP.

Detailed Guideline 2 c) i) d)

We note that this guideline refers to “the additional complexity of such contagion risks” in the context of multi-CCP interoperability.

We are unclear whether the concept of “contagion risk” has a common and universally accepted definition. We think this guideline could usefully add such a definition and an example of what might constitute contagion risk that regulators would be looking to assess. This would enable mitigants to be more clearly identified such as the exchange of collateral between interoperating CCPs.

Detailed Guideline 2 e) (i)

This guideline requires the NCA to take into account whether “the CCP has assessed the risk profile of each interoperating CCP, including its membership policies, to ascertain that they do not result in a weakening of the CCP’s overall risk management framework”.

EuroCCP believes that whilst it is important to understand the range of clearing activities, the financial strength and overall risk management methodologies employed by an interoperating CCP it is not necessary or practical to draw conclusions regarding the strength or weakness of the overall interoperability risk management framework by reference to the membership policies of the interoperating CCP. This is due to a number of factors:

- i) Interoperating CCPs have trade exposures to each other and not to the members of the interoperating CCP. As such, risk management primarily involves margining the interoperating CCP based on those trade exposures. Assuming that the inter CCP margin collection is calculated appropriately and collected on a timely basis the strength or weakness of the interoperating risk management framework should not be materially affected by two interoperating CCPs having different membership policies as the margin calculation is determined by reference to trade exposures of the interoperating CCP.
- ii) Whilst it can be argued that the reason an interoperating CCP might default in relation to its obligations to another CCP would in most cases be as a result of the default of multiple members of that CCP we do not believe that a CCP can derive a correlation between the membership criteria of another CCP and the propensity of that CCP’s members to default which would enable a CCP to determine that interoperating with another CCP would weaken the first CCP’s overall risk management framework.
- iii) Interoperating CCPs are regulated entities which will have been authorised under EMIR by the applicable NCA and college of supervisors. As such, EMIR expressly requires CCPs to establish admission criteria which ensure

members have sufficient financial resources and operational capacity to meet obligations arising from participation in a CCP. EMIR also requires members that clear transactions on behalf of clients to have necessary additional financial resources and operational capacity to perform that activity. Given the prescriptive nature of these requirements it is difficult to see what purpose is served by having another CCP review the existing membership criteria of another CCP. If a CCP has been authorised it will be operating admission criteria in compliance with the criteria set out above. This in turn would mean that the member admission criteria employed by a CCP will be designed to ensure that CCP's ability to meet its obligations as opposed to weakening its ability to meet its obligations.

- iv) An interoperating CCP may, prior to interoperating with another CCP, be the sole CCP providing clearing services to a particular trade venue or market. As such, that CCP may historically have needed to offer access to the entire range of market participants given its status as sole clearer. This may well have necessitated the operation of wider membership criteria than a CCP that has not been required to service all market participants requiring access to clearing services. Accordingly, as a requirement of access to clearing by the market place, membership criteria may necessarily be different between CCPs. That differential should be recognised and should not be viewed in a manner which would foreclose access to clearing services.

Detailed Guideline 2 e) ii)

We believe that this guideline should also require the CCP to assess the benefits of interoperability when reviewing interdependencies i.e. that in relation to trading platforms, interoperability can remove a single critical provider dependency by introducing alternative clearing arrangements to the platform where the incumbent CCP is unable to provide clearing services.

EuroCCP appreciates the opportunity to comment on the Consultation Paper. We would be pleased to provide ESMA with any additional information or analysis that might be useful in determining the final form of the guidelines. This response is not confidential.

Yours faithfully



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