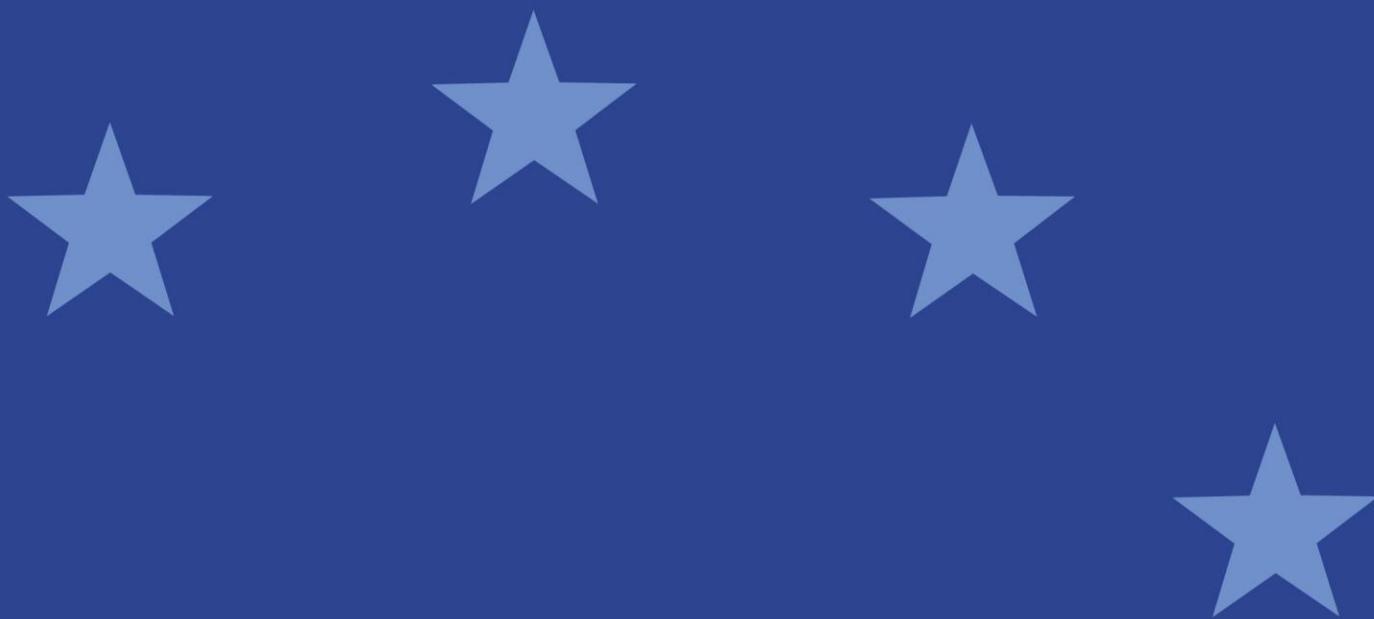




European Securities and
Markets Authority

Consultation Paper

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



Responding to this paper

ESMA invites comments on all matters in this paper. Comments are most helpful if they:

- contain a clear rationale;
- include quantitative elements to support any concern; and
- describe any alternatives ESMA should consider, including alternative drafts.

ESMA will consider all comments received by **31 January 2013**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input – Consultations'.

Publication of responses

All contributions received will be published following the close of the consultation period, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading 'Legal Notice'.

Who should read this paper

All interested stakeholders are invited to respond to this consultation paper. In particular, responses are sought from central counterparties (CCPs).

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Acronyms used

EMIR	European Market Infrastructures Regulation – Regulation of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories – also referred to as “the Regulation”.
NCA	National Competent Authority
CCPs	Central Counterparties
IA	Interoperability Arrangements

I. Executive Summary

Reasons for publication

This paper is published to consult on draft ESMA guidelines issued in accordance with Article 16(2) of Regulation (EU) No 1095/2010 (ESMA Regulation) and as required under Article 54(4) of Regulation (EU) 648/2012 on OTC derivatives, central counterparties and trade repositories (the Regulation or EMIR).

Contents

Section II explains the background to the draft guidelines in the context of ESMA's work on developing standards for CCPs.

Section III sets out and explains the draft guidelines for establishing consistent, efficient and effective assessments of interoperability arrangements.

Next steps

ESMA will consider the responses it receives to this consultation and expects to publish final guidelines by the end of Q1 2013.

The draft guidelines are separate from the work ESMA has done to produce draft Regulatory and Implementing Technical Standards (technical standards) under EMIR. The guidelines will clarify obligations for National Competent Authorities (NCAs) in relation to their assessment of applications from CCPs to enter into interoperability arrangements.

II. Background

1. Under Article 54(4) of EMIR, ESMA is required to issue by 31 December 2012 guidelines or recommendations with a view of establishing consistent and effective assessments of interoperability arrangements.
2. On 27 September 2012 ESMA delivered its draft technical standards on CCP requirements to the Commission, as required under EMIR. These draft technical standards are expected to be endorsed by the Commission by 27 December 2012. Following the Commission endorsement the European Parliament and the Council have from 1 to 6 months to object to the technical standards depending on:
a) whether the Commission will endorse them without amendments; b) whether the Council and the Parliament will extend their non-objection period.
3. Therefore, the technical standards are unlikely to enter into force before 1 March 2013. 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. Against this background, ESMA has prioritized the work on the technical standards and is therefore launching this consultation (and not the final guidelines) before 31 December 2012. In prioritizing work on the technical standards, ESMA considered that the applicability of the guidelines will not be immediate and that finalising these guidelines by 31 December 2012 would have required compressing or skipping the consultation period, which is undesirable for such a complex, technical and relevant matter. Given that the guidelines 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. It is, therefore, currently consulting with the objective of issuing the final guidelines by the end of the first quarter of 2013, which will still be before any CCP is authorised under the EMIR regime.
5. The objective of these guidelines is to improve the rigor and uniformity of standards applied in the assessments of interoperability arrangements. The guidelines define what NCAs should look at 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 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 safe and sound interoperability arrangements.
7. The guidelines 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.
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 certainty 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 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 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 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 to, 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 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 on cooperation between NCAs have been designed to ensure a smooth approval process of the interoperability arrangement.

13. Comments are welcome on all the sections and annexes of this consultation paper.

Respondents are invited to clearly highlight the section and provisions to which their comments refer and provide supporting data whenever possible. In particular, in view of the consideration made in the annexed impact assessment, ESMA draws the attention of respondents to the provision in proposed Guideline 3(e)(i) that a CCP assess the membership policies of an interoperating CCP to ascertain that they do not result in a weakening of the CCP's overall risk management framework.

III. Draft Guidelines

This section sets out the text of the proposed Guidelines.

ASSESSMENT OF INTEROPERABILITY ARRANGEMENTS

- 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 National Competent Authorities (NCAs), when reviewing an interoperability proposal pursuant to Article 54 of the Regulation, assess the application against the criteria set out in Guidelines 1 to 5 below.

Guideline 1. Legal risk

Relevant legislation.

Article 52(1), paragraphs (a) and (b) of the Regulation.

General guideline

1. A NCA should assess that the interoperability arrangement is clearly defined, transparent, valid and enforceable in all relevant jurisdictions.

Detailed guidelines

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

a) Documentation

That the documentation governing the interoperability arrangement:

- 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 indicates 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

- i. That the CCP has assessed whether the netting arrangements between the interoperating CCPs are valid and enforceable.
- ii. That the CCP has assessed whether 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 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 whether its procedures for the management of the default of the interoperable CCP are valid and enforceable.
- v. That the CCP has conducted 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.

Guideline 2. Open and fair access

Relevant legislation.

Article 51(2), and (3) of the Regulation.

General guideline

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

Detailed guidelines

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

Guideline 3. Identification, monitoring and management of risks

Relevant legislation.

Article 52(1), paragraphs (a), (c) and (d), and Article 52(2) of the Regulation.

General guideline

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

Detailed guidelines

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

a) General policies, procedures and systems

- 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 third countries regulations. In this respect, these requirements should be met by every CCP on a standalone basis, in particular with reference to pre-funded financial resources including margins.
- ii. That the CCP has comprehensive information on the operations of the 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.
- iii. That the CCP has put in place measures, procedures and systems to identify, monitor, assess and mitigate any new or increased risk, interdependencies or spill over effects that may arise from the interoperability arrangement.
- 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 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 spill-over 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.
- viii. 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.
- ix. That the communication arrangements between the interoperable CCPs ensure timely, reliable and secure communication.

- x. That the CCP's default management procedures are designed to ensure that the default of one clearing member of one CCP does not affect the operations of the interoperable CCPs or expose them to additional risks.
- xi. That the CCP has assessed the need for specific default management procedures in view of the interoperability arrangement.
- xii. That the procedure for the termination of the interoperability arrangement by any of the interoperable CCPs is clear and transparent and will result in implementation in an orderly manner that does not unduly expose the interoperable CCPs to additional risks.

b) Prudential requirements

- 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 and to ensure that it is adequately covered for current and potential future credit and liquidity exposures arising from the interoperable CCPs.
- iii. That the CCP has assessed 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 resources exchanged between interoperable CCPs do not include contributions to the respective default funds or other financial resources as defined in Article 43 of the Regulation.

c) Interoperable CCP default

- i. That the CCP has assessed the potential effects of an interoperable CCP's default, including:
 - a. the CCP's potential exposures arising from uncovered credit losses if an interoperable CCP's default waterfall has been exhausted;
 - b. the degree to which the portability of positions and a dedicated default fund of the interoperable CCP would contribute to the lowering of the inter-CCPs exposures;
 - c. ensuring that risks introduced by the interoperability arrangement are disclosed to the clearing members in line with the Article 38(2) of EMIR and Article 10 of the draft Regulatory Technical Standards on CCP Requirements (Commission Delegated Regulation (EU) No .../.. of [date]);
 - d. where more than two CCPs participate in an interoperability agreement, the additional complexity of such contagion risks;
 - e. 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

- i. That the CCP has a process for regularly assessing differences between the risk-management models and membership controls of the interoperating CCPs and the 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.

e) Risk profile and membership criteria

- i. That 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, in the context of the interoperability arrangement.
- ii. That the CCP has policies, procedures and systems to constantly 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

- 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 the technical standards on CCP requirements.
 - 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, that are transparent to its clearing members, to meet exposures arising from the interoperability arrangement, including in extreme but plausible market conditions.

Guideline 4. Deposit of collateral

Relevant legislation.

Article 53(3) of the Regulation.

General guideline

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.

Detailed guidelines

2. In applying the general guideline NCAs should at least take into account that the interoperating CCP has undertaken appropriate due diligence to ensure that the collateral:

- a. is deposited in a bankruptcy remote manner, thus it will not be affected by the default of any other interoperable CCP;
- b. will be available in a timely manner when needed.

Guideline 5. Cooperation between NCAs

Relevant legislation.

Article 54(2)

General guidelines

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 co-operate 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.
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. 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.

Questions

- 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?**
- 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.**
- Q3: Is it appropriate to consider an assessment by CCPs of the membership criteria of interoperable CCPs?**
- Q4: Do you have additional comments on the draft guidelines?**

Annex I

Text of relevant legislative provisions in EMIR

EMIR Art 51 Interoperability arrangements

1. A CCP may enter into an interoperability arrangement with another CCP where the requirements laid down in Articles 52, 53 and 54 are fulfilled.
2. When establishing an interoperability arrangement with another CCP for the purpose of providing services to a particular trading venue, the CCP shall have non-discriminatory access, both to the data that it needs for the performance of its functions from that particular trading venue, to the extent that the CCP complies with the operational and technical requirements established by the trading venue, and to the relevant settlement system.
3. Entering into an interoperability arrangement or accessing a data feed or a settlement system referred to in paragraphs 1 and 2 shall be rejected or restricted, directly or indirectly, only in order to control any risk arising from that arrangement or access.

EMIR Art 52 Risk management

1. CCPs that enter into an interoperability arrangement shall:
 - (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.

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.
3. Any associated costs that arise from paragraphs 1 and 2 shall be borne by the CCP requesting interoperability or access, unless otherwise agreed between the parties.

Article 53 Provision of margins among CCPs

1. A CCP shall distinguish in accounts the assets and positions held for the account of CCPs with whom it has entered into an interoperability arrangement.
2. If a CCP that enters into an interoperability arrangement with another CCP only provides initial margins to that CCP under a security financial collateral arrangement, the receiving CCP shall have no right of use over the margins provided by the other CCP.
3. Collateral received in the form of financial instruments shall be deposited with operators of securities settlement systems notified under Directive 98/26/EC.
4. The assets referred to in paragraphs 1 and 2 shall be available to the receiving CCP only in case of default of the CCP which has provided the collateral in the context of an interoperability arrangement.
5. In case of default of the CCP which has received the collateral in the context of an interoperability arrangement, the collateral referred to in paragraphs 1 and 2 shall be readily returned to the providing CCP.

Article 54 Approval of interoperability arrangements

1. An interoperability arrangement shall be subject to the prior approval of the competent authorities of the CCPs involved. The procedure under Article 17 shall apply.
2. The competent authorities shall grant approval of the interoperability arrangement only where the CCPs involved have been authorised to clear under Article 17 or recognised under Article 25 or authorised under a pre-existing national authorisation regime for a period of at least three years, the requirements laid down in Article 52 are met and the technical conditions for clearing transactions under the terms of the arrangement allow for a smooth and orderly functioning of financial markets and the arrangement does not undermine the effectiveness of supervision.
3. Where a competent authority considers that the requirements laid down in paragraph 2 are not met, it shall provide explanations in writing regarding its risk considerations to the other competent authorities and the CCPs involved. It shall also notify ESMA, which shall issue an opinion on the effective validity of the risk considerations as grounds for denial of the interoperability arrangement. ESMA's opinion shall be made available to all the CCPs involved. Where ESMA's opinion differs from the assessment of the relevant competent authority, that competent authority shall reconsider its position, taking into account ESMA's opinion.
4. By 31 December 2012, ESMA shall issue guidelines or recommendations with a view to establishing consistent, efficient and effective assessments of interoperability arrangements, in accordance with the procedure laid down in Article 16 of Regulation (EU) No 1095/2010.
ESMA shall develop drafts of those guidelines or recommendations after consulting the members of the ESCB.

Annex II

Cost-benefit analysis of the draft guidelines for establishing consistent, efficient and effective assessments of interoperability arrangements

I. Introduction

1. The objective of performing a cost-benefit analysis is, in the context of Guidelines, to assess the costs and benefits of the various policy or technical options which were discussed during the process of drafting the guidelines. The guidelines 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.
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 EMIR¹. The choices or options envisaged by ESMA while drafting these guidelines 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 be?

4. When drafting the guidelines, ESMA considered the level of granularity which they should entail. ESMA considered that if the guidelines 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 defined in an overly broad manner might result

¹ http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/20100915_impact_assessment_en.pdf

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.

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 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 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 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 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 such guidelines 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, 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 for NCAs to follow in assessing IA.
12. Where these detailed guidelines involved specific policy choices which might give rise to material cost implications then these are discussed below.

III. Guideline on Legal basis

13. Regarding the legal basis of the IA, ESMA specifically contemplated how the guidelines 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, will need to 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 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 considered regarding exchange of information and membership criteria had potential material cost implications:

1. Exchange of information

17. EMIR Article 52(1)(c) 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 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 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 what NCAs should expect to find in terms of when, how and what interoperable CCPs communicate with each other. ESMA has also specified guidelines regarding the process that NCAs should expect to find with regards to a protocol for notification and consultation between

interoperating CCPs of any changes to one CCP's rules 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 1 on legal risks, CCPs are not supposed to assess requirements already assessed by the relevant NCA, thus duplicating their job. However, although EMIR requirements are applicable in a consistent manner to all European CCPs, the same is not true for third country CCPs which are subject to equivalent requirements that in the context of an interoperability arrangement might give rise to risks for the European CCP interoperating with a third country one.
24. General assessment by a CCP of the risk profile of the CCPs with which it interoperates is a requirement already imposed by EMIR. ESMA considers that the membership criteria of an interoperable CCP forms part of the risk profile of that CCP and therefore concluded that NCAs should expect to see that their CCPs have evaluated the membership criteria of an interoperable CCP as part of the broader assessment undertaken by the CCP.