

**Comments of the European Association of Central Counterparties  
(EACH) on the draft CESR-ESCB Recommendations for Settlement  
Systems and Central Counterparties**

This document contains the response of EACH to the CESR/ESCB Consultation Paper CESR/08-749 on the Draft Recommendations for Securities Settlement Systems and Draft Recommendations for Central Counterparties.

EACH welcomes the fact that the ECB and CESR has decided to re-start this process in which EACH has played an instrumental role. We very much appreciate the open approach that has been taken to the consultation process and hope that this will continue as the Recommendations are finalised. We also welcome the work being undertaken to examine any adaptations necessary in relation to the clearing of OTC derivatives markets.

We are ready to answer any questions raised by these comments.

January 22, 2009



## Summary of comments

These fall into seven main categories:

### A. Structural issues

The intended application to derivatives, and especially OTC derivatives, raises two issues:

One is that the fundamental value and benefit of a CCP varies in terms of relative balance across asset classes, and there should consequently be a stronger focus on process efficiency in securities clearing and on risk management in derivatives clearing. Therefore the importance of a Recommendation may differ depending on the specific activities of the CCP under assessment.

It also questions the fundamental structure which appears to be addressed to (the regulators of) securities settlement systems, with other pre- and post-trade processes conceived as adjuncts, rather than complementary, to settlement. Included here are comments on the SSS Recommendations related to trade confirmation and to CCPs. In retrospect, a better structure could have been to have three parts: the first addressing structural and pre-clearing processes, which might be addressed to the operators of trading facilities; the second considering CCPs; and the last considering SSSs. However this may be impractical at this stage and to an extent the issues more closely related to trading are MiFID matters.

### B. The need to recognise the wholesale scope of CCPs

The reference in paragraph 7 c. of the Introduction refers to the need to foster the protection of retail investors. While we of course full support this key objective, the structures and responsibilities of European CCPs are designed primarily to protect market participants, and to support other elements of the overall supervisory framework in their responsibility of protecting investors. It is therefore necessary to make some amendments to the Recommendations to make this clear.

### C. Missing/weakened Recommendations

As takers of collateral, some CCPs act in a limited custodial capacity. There should be a Recommendation for CCPs covering similar issues to Recommendation 12 for SSSs, applicable to CCPs that take collateral in their own name. CCPs also appear to be under a weaker obligation to provide adequate business continuity, with which we do not agree.

### D. Strengthening of the transparency obligation

In some parts the transparency requirements have been weakened in comparison with the CPSS-IOSCO Recommendations, which should be corrected.

E. Addition of a harmonisation requirement

Supervisors of SSSs are encouraged to foster harmonisation, but not supervisors of CCPs. The same systemic concerns arise, however.

F. Issues related to CCP links

There are a number of references to CCP links both in Recommendation 11 and the other Recommendations, and it is often not clear why issues related to a participant are absent or different when related to a linked CCP. We believe it increasingly unlikely that a CCP would wish to, or be allowed to, become a regular participant of another CCP. Nevertheless the case should be allowed for, but differentiated from the expected – but still unusual – case where two CCPs link together on an interoperable basis while remaining in all respects de jure CCPs.

In order to simplify the structure, therefore, we recommend that it is made clear that in the case where a CCP acts as a clearing member of another CCP, all Recommendations – except Recommendation 11 – apply and are to be followed in relation to the “member” CCP; while Recommendation 11 should concentrate on Interoperability between CCPs only. This is of relevance notably in Recommendation 1, which refers to “linked” or “interoperable” CCPs, but recurs throughout.

Accordingly, all references to CCP links should be erased from the Recommendations and left only in Recommendation 11.

G. Other changes

These arise from the need inter alia to reflect properly the relevance of the Introduction to CCPs as well as CSDs, to address the confusion introduced by trying to harmonise the descriptions of CSD and CCP banking arrangements, correcting references to guarantee arrangements, considering the application to derivatives, including commodity derivatives, as well as to securities, correcting references to a “system”, governance, and other corrections and omissions.

## **INTRODUCTION**

### **The objectives of the Recommendations**

7. In the list of objectives, c. and d. should refer to derivatives as well as to securities on the assumption that, for the time being, the terms “securities” and “derivatives” encompass all instruments that are processed by EU CCPs; but the objectives may differ as between these broad segments. Public authorities have not called for the same degree of integration and harmonisation in derivatives markets as they have for securities, and such integration may not be desirable. The answer may be to move the reference to “competitiveness” from c. to d. and extend d., so that c. reads “sustain the integration and, where needed, harmonisation...” and that d. reads “efficient functioning and competitiveness of securities and derivatives markets”.
8. This paragraph should include, as its opening sentence, the statement that “The objective of promoting and sustaining “integration” should not be taken as meaning the institutional integration of market infrastructures.”

### **The nature of these Recommendations**

10. It would be helpful to clarify that the reference to an institution subject to existing EU regulations includes CCPs as well as CSDs, as the earlier part of the paragraph discusses CSDs exclusively.
11. In Principle a., end of third line, CCPs should presumably be added to CSDs and other operators of securities settlement systems/arrangements as being required to provide securities regulators and central banks with necessary information.

In Principle b., the conditions under which Member States may be allowed to impose additional obligations should be strictly monitored by ESCB and CESR and objectively and transparently justified.

In Principle c., authorities should be required to disclose at least summary information pertaining to the results of their assessments.

### **The ambit of the ESCB-CESR Recommendations for CCPs**

14. The reference to the lack of a harmonised EU regulatory régime for CCPs, compressed into “Currently the regulation of CCPs is not harmonised in Europe.”, should be amplified and placed into a separate paragraph, with reference made to some of the differing requirements in EU member states, e.g. the need to be a credit institution, or the presence of a specific CCP or clearing house status.

The comment about market participants being unable to manage their risks is presumably supposed to refer to markets where there is no CCP, but this is not clear.

The reference to mandatory use of a CCP making bilateral risk management unnecessary should be qualified to refer to risks between clearing members.

## **Guarantee arrangements and Clearing intermediaries**

18. Given the proposal that the Recommendations are intended to apply to guarantee arrangements as well as CCPs, it might be helpful to add a comment such as “throughout this document references to CCPs should be read as including guarantee arrangements” – here or near paragraph 45.

It should also be made explicit that the Recommendations should not be applied to clearing intermediaries, which is the implication.

## **Relationship to the work of other European initiatives**

### **A. Public Initiatives**

#### ***- Communications from the European Commission and the Code of Conduct***

21. It is the Commission’s assertion that the Code is a private, not a public, initiative. This paragraph should be moved to the next section.
22. In the third line, the words “no harmonised EU-framework ... until today” implies that today there is a harmonised framework. A better form of words would be “at the moment” rather than “until today”.

## **Issues and developments deserving further study**

34. It should be made clear whether ESCB-CESR feels that there is justification for an “in-depth study” on governance and internal control in the clearing process, as well as the settlement process, and if so when and how this study will be undertaken.

## **Assessments against these Recommendations**

35. Concrete proposals concerning the new arrangements to develop a coherent interpretation of specific Recommendations should be made, or at least there should be encouragement for authorities to work towards convergence of their interpretations.

## **PART 1: DRAFT RECOMMENDATIONS FOR SECURITIES SETTLEMENT SYSTEMS**

There are a number of points that arise from the (necessary) differentiation between Part 1, which addresses securities settlement systems, and Part 2, which addresses all central counterparties.

### **RECOMMENDATION 2: TRADE CONFIRMATION AND SETTLEMENT MATCHING**

The above point is relevant here, as there are no recommended supervisory standards for trade confirmation and settlement matching for derivatives trades. If that is the current or future intention, it raises the question of whether this Recommendation should properly have been included in a separate set of general Recommendations.

A CCP Recommendation dealing with TRADE CONFIRMATION AND SETTLEMENT MATCHING is missing but – in the case of CCP-eligible exchange-traded products – it is in fact the CCP who provides such confirmations (in the case of novation or acceptance of trades matched under “open offer” rules), and/or is the legal counterpart in the settlement matching process and will typically in effect issue pre-matched settlement instructions to a settlement system.

There should be a greater encouragement for the use of CCPs as a way of enforcing fast and efficient processing along the value chain, including but not limited to trade matching and settlement matching. This could be included in SSS Recommendation 4 below.

### **C. Explanatory memorandum**

2. In lines 7-8, as a general principle, the results of the netting process also need to be matched; however it can be the case that the settlement environment allows for the input of already matched instructions, e.g. Power of Attorney processing for members performed by the CCP.

## **RECOMMENDATION 3: SETTLEMENT CYCLES AND OPERATING TIMES**

### **C. Explanatory memorandum**

6. At the end of the paragraph, it is not the *netting* that addresses the risk described in paragraph 5, but the interposition of the CCP (that risk would also be addressed in cases where the CCP settles gross).

## **RECOMMENDATION 4: CENTRAL COUNTERPARTIES (CCPS)**

The same point arises as noted under Recommendation 2.

### **B. Key issues**

2. Reference is made to a “checklist for guarantee arrangements”, which is not present in the document.

## **RECOMMENDATION 8: TIMING OF SETTLEMENT FINALITY**

### **B. Key issues**

4. The rules of the system should permit a CCP to unilaterally withdraw a settlement instruction as part of the exercising of the CCP’s default rules, subject to the system’s own settlement finality rules.

### **C. Explanatory memorandum**

6. The rules of the system should permit a CCP to unilaterally withdraw a settlement instruction as part of the exercising of the CCP’s default rules, subject to the system’s own settlement finality rules.

## RECOMMENDATION 14: ACCESS

### C. Explanatory memorandum

7. CSDs should also, where consistent with law and public policy, grant access to foreign CCPs.

## PART 2: DRAFT RECOMMENDATIONS FOR CENTRAL COUNTERPARTIES

### RECOMMENDATION 1: LEGAL RISK

#### B. Key issues

1. The final sentence is redundant, and should be deleted.
- ✘ The comments under B 6 in Recommendation 1 for Securities Settlement Systems should be repeated here: “For systemic risk purposes, the relevant public authorities should support the harmonisation of rules so as to minimise any discrepancies stemming from different national rules and frameworks.”

#### C. Explanatory memorandum

1. In the second sentence, it should be clear that the law should support a CCP’s *right* to obtain information about underlying customers, not an *obligation*.
2. First sentence: “In most jurisdictions, the legal concept that enables a CCP to become the counterparty is either novation or open offer.” – the use of the phrase “in most jurisdictions” recognises that there are jurisdictions where it is possible to become a counterparty without using the principle of either novation or open offer (as in the case with guarantee arrangements). According to the Assessment Methodology for Legal Risk (RCCP 1) the rating will cover among other things having a legal basis for novation or open offer. Relevant changes should be introduced to the assessment methodology to reflect the possibility of other legal concepts than novation and open offer.
3. At the end of the paragraph, the reference to the need for insolvency laws supporting the protection of cash collateral provided to a CCP should ideally be extended to ensure the protection of such cash following the insolvency of a bank that is holding the cash, if the legal framework so allows. We recognise that this proposal raises fundamental issues concerning insolvency and potentially competition laws, but nevertheless believe that as a long-term goal such protection should be available in order to contain systemic risk.
7. In line 8 the reference to “financial instruments” should be extended to include commodities.
8. The requirements in this paragraph should apply in all cases regardless of whether or how a CCP’s activities cross borders. We suggest the first sentence should start at “The rules governing the CCP’s activities...”.

In lines 4, 5, 13 & 14 the word “chosen” should be removed and the references read “the law governing”. As a general rule, there will be no, or very limited, “choice” of law, as this will be determined by factors including the location of the CCP.

In line 6 and 16 the reference to “a system”, which is presumably taken from the original references in preceding texts to settlement systems, should be replaced by “a CCP”.

In line 15 the reference to “securities” should be extended to include commodities; ideally this should apply throughout the document, including the references to the Objectives at page 5 (if the objective had indeed originally been to include commodities).

In line 17 the reference to “intermediary” is presumably meant to refer to a clearing member or participant (as noted in footnote 8). It is questionable why relevant jurisdictions should include those of a member’s customer, or a member’s customer’s bank and if so, surely the member’s bank should be included.

10. In line 5, the words “chosen in connection with” should be replaced by “governing”; in line 7 the words “is chosen to govern” should read “governs”; and in line 8 the word “chosen” should be removed.

In line 8 the reference to “a system” should be replaced by “a CCP”.

- ※ The comments under C 9 in Recommendation 1 for Securities Settlement Systems should be repeated here.

## **RECOMMENDATION 2: PARTICIPATION REQUIREMENTS**

### **C. Explanatory memorandum**

1. There should be a reference to the need to examine in particular issues relating to the participation of non-residents (e.g. in this context from outside the EU + Switzerland) and the ability to undertake the necessary monitoring and other risk management processes in relation to these entities.
2. The reference to “third-party review” should be clarified. What sort of third party is envisaged? In any case it should be clarified that such a review does not imply arbitration, i.e. no binding ruling can be made by such (presumably “independent”) third party.

In line 9 the reference to “a system” should be replaced by “a CCP”.

3. The words “if the participant is a clearing participant” imply that a participant in a CCP might not be a “clearing” participant”. Presumably the reference is to “General Clearing” members/participants, and should therefore read “if the participant clears for other market participants”.
6. There should be an obligation put on regulators and supervisors to share relevant information with a CCP in cases where those authorities have information concerning

developments that may affect supervised entities' continuing ability to perform obligations.

### **RECOMMENDATION 3: MEASUREMENT AND MANAGEMENT OF CREDIT EXPOSURES**

#### **B. Key issues**

1. The word “should” should be replaced by “must”.

#### **C. Explanatory memorandum**

3. “should ensure that defaults by participants...”; it is economically not achievable to ensure in the case of significant multiple simultaneous defaults; the default of the largest participant “must” (not “should”) be covered at a minimum.
5. The reference to trading limits should be expanded to include “or provisions whereby trades may be held prior to acceptance by the CCP until additional collateral is provided or other action is taken”.

### **RECOMMENDATION 4: MARGIN REQUIREMENTS**

#### **B. Key issues**

3. The key point is to ensure that assets accepted to meet margin requirements can be liquidated to meet obligations as they fall due. We do not support the use of the term “highly liquid” as this is too imprecise. The provision of less liquid assets should be allowed provided that adequate haircuts are applied to their value. Furthermore it should be allowed that an “illiquid” asset can be accepted in cases where it will not have to be liquidated in order to meet the obligations, for example a security provided to support a short position. This is the intention of footnote 37 which however implies in our view too narrow an interpretation of this qualification. Margin requirements can in effect be waived if the terms of the contract have effectively been fulfilled via early delivery of the underlying asset.

#### **C. Explanatory memorandum**

1. The words “unless the CCP can demonstrate that the calculation and collection of margins are impossible or inappropriate” should be deleted.

### **RECOMMENDATION 5: OTHER RISK CONTROLS**

#### **A. The Recommendation**

As the second sentence, we propose the addition of “These resources will include any clearing fund provided by participants or other parties, loss-sharing arrangements, insurance arrangements, capital, parental guarantees or other similar provisions.”, and the next sentence should begin “In order to assess the adequacy of these resources, the CCP should develop plausible scenarios...”

## **B. Key issues**

1. Supervisory authorities should be encouraged to seek harmonisation of the bases for stress-testing, including appropriate scenarios and parameters, in order to ensure consistency between CCPs.

It is stated that “The stress testing assumptions that a CCP uses in reaching a judgment about the adequacy of its resources should be disclosed to participants and authorities.” CCPs should not be under any obligation to share their stress-testing assumptions with participants, although may choose to do so.

## **C. Explanatory memorandum**

2. On the basis that all matters relating to a linked CCP that is accepted as a regular participant are covered by this Recommendation by definition (see introductory comment F), the sentence that states that linked CCPs that have been assessed against Recommendation 11 not be considered when identifying the largest residual exposure should be deleted.

In the fourth sentence, there should be added to the list of other relationships the possibility of the participant being the issuer of a security being cleared, or a reference entity for a credit default swap.

- 5 As noted under B 1, CCPs should not be under any obligation to share with participants stress-testing assumptions and, in particular, results.
- 7 The second sentence should be deleted as margin does not form part of the financial resources addressed by this Recommendation: the margin is there as the first line of defence protecting these resources.
- 12 The term “default fund” should be replaced by “clearing fund”.

## **RECOMMENDATION 6: DEFAULT PROCEDURES**

### **B. Key issues**

1. It is not clear what is meant by “mechanisms other than those of the CCP” – if it means actions by public authorities or insolvency administrators/liquidators (and we fully support that there are clear mechanisms in both cases), this is not something within the powers of CCPs to ensure.
- 2 The Recommendation on the identification and separate treatment of customer and proprietary assets should make it clear that there is no obligation to do so in relation to individual customers, and in particular retail customers, with whom a CCP will generally have no relationship.

### **C. Explanatory memorandum**

4. It is not clear under what circumstances the transfer of a defaulter’s proprietary positions would be appropriate.

5. The opening sentence should read “The default procedures of a CCP (or mechanisms other than those of a CCP) should provide for...”.
8. It should be stated that as far as possible, and while ensuring there is no threat to the confidentiality of data, default management exercises should be based on real and live participant positions and market data.
9. The CCP has no concern over “the defaulting participant obligations to its customers”, so this text should be deleted.

## **RECOMMENDATION 7: CUSTODY AND INVESTMENT RISKS**

### **A. The recommendation**

The Recommendation is unobjectionable. However it should be supplemented, or a new Recommendation added, similar to Recommendation 12 for SSSs on Protection of Customers’ Securities, applicable to CCPs which directly hold participants’ (or their customers’) securities as collateral.

### **B. Key issues**

1. The opening passage, as far as “... Securities Settlement Systems”, appears redundant.

### **C. Explanatory memorandum**

2. At the end of the paragraph, we suggest that it is made clear that where a CCP is able to rely on regulatory assessments of custodians that therefore there is no obligation for the CCP to perform its own audit.
3. At the end, it should read “a CCP should set limits to this use of cash margins”.

## **RECOMMENDATION 8: OPERATIONAL RISK**

### **B. Key issues**

3. In Recommendation 3 for SSSs (B 3) it is stated that “The emergency plans of CSDs should allow them to extend operating hours to ensure safe and complete settlement in case of emergency”. The same should apply to CCPs.

### **C. Explanatory memorandum**

9. The reference to “independent” auditors should allow the use of internal audit resources rather than external auditors.
11. This states that “a second site should be established”: the same comment applies as at B 3. This is weaker than the related Recommendation to SSSs (11 C 11) which states that “CSDs must set up a second processing site”. We do not see why it is any less critical for CCPs.
13. This belongs more to Recommendation 11.

15. “Achieving diversity” of key suppliers may not be adequate to ensure business continuity. We suggest this requirement should read “A CCP should manage this risk by seeking to achieve diversity in key systems such as electricity and telecommunications, and/or make back up arrangements, to the extent possible.”.

## **RECOMMENDATION 9: MONEY SETTLEMENTS**

### **C. Explanatory memorandum**

1. In an attempt to harmonise the terminology with that for SSSs (described, but not justified, in footnote 47) there is a loss of comprehensibility. The term “settlement agent” appears to apply either to the central bank (in the central bank model) and what is generally called the “concentration bank” in the private settlement agent model. However it is wrong to suggest that this “agent” is always “the entity whose assets are used to settle the ultimate payment obligations to the CCP” as described in further detail in paragraph 9.

Furthermore it should be clarified that this Recommendation does not extend to banks acting only as settlement agents for a CCP’s participants.

2. To make this clear, the reference to the “cash settlement agent” at the end of line 9/start of line 10, and the reference to the “settlement agents” in line 12, should read “settlement bank(s)”, as in B 4, leaving the reference to the “cash settlement agent” later in line 9 to refer to the concentration bank.
4. This, if taken as a description of the operation of the “central bank model”, appears to suggest that it does not necessarily have to use central bank money, which is counter-intuitive. There should be a clear description of the model including the direction to use central bank money if possible. It seems the intention was to define two models:
  - a) where the CCP and all its participants have accounts at the same bank, either
    - i) the central bank, where practicable and feasible, or
    - ii) a commercial bank; and
  - b) where the CCP and its participants have accounts at various commercial banks, and the CCP uses as a concentration bank either
    - i) the central bank, where practicable and feasible, or
    - ii) a commercial bank.

In any case one or two diagrams would be helpful.

- 6-9. The recommendations on settlement agents should also apply in relation to settlement banks.
10. The recommendation should apply equally to all currencies (with euro as the quoted example).

## RECOMMENDATION 10: PHYSICAL DELIVERIES

### C. Explanatory memorandum

1. In the description of a CCP's role in the settlement process it would be helpful to have some reference to the effect of netting. This is likely to give rise to DvP settlements where the value of the cash and the value of the security or commodity being delivered may differ significantly; indeed netting systems have to cater for outcomes such as both cash and instruments being transferred to the same participant, or only cash or only the instrument, or neither.
6. The point in footnote 50 should be made a fortiori in Recommendation 9, e.g. at C 4.  
The reference to “pricing” in line 9 should be amended to read “charging”.

## RECOMMENDATION 11: RISKS IN LINKS BETWEEN CCPS

### C. Explanatory memorandum

2. The references to the forms of link, taken from the Code, do not seem fully appropriate. In such a document one would expect a discussion of whether a CCP can, or should be able to, become a participant of another CCP while still remaining a CCP (see below under E 3 1 for this Recommendation). The description of Interoperability in the Code is an all-encompassing form of words that attempted to cover all potential future relationships between all layers of the infrastructure, before the detailed work had been done in the Guideline. Interoperability between CCPs has come to mean structures whereby CCPs become contractual counterparties to each other, superficially similar to a CCP-member relationship, but where each CCP retains its CCP status and is not a “participant” of the other (see the Guideline), *in order for participants in the other to use the same trading venue but choose the CCP*; see below. This is consistent with the definition of “interoperable systems” in the Glossary.

We also note that reference to the fourth type of link described in the CPSS-IOSCO Recommendations has been erased (*“In the most integrated form of link, the CCPs effectively merge their systems to offer a single clearing platform. The participant of one CCP will continue its relationship with that CCP, but all risk management is effected by the wholly integrated systems of the linked CCPs. The participation, default, margin requirements, financial resources and operational requirements, to which CCP participants are subject become harmonised and may thus differ from the requirements in place at one or both of the CCPs prior to the link.”*). It is our opinion that such a type of link could be usefully re-integrated into the ESCB-CESR Recommendations, clarifying that in this case the relationship between the linked CCPs is not of an outsourcing type but falls under this Recommendation.

3. Some definition is needed: the term “cross-participation link” refers to any link, e.g. the theoretical case of a CCP becoming a participant in the other (if that were ever possible), an interoperable link, and a similar type of link (e.g. between the CCPs

serving NASDAQ OMX's linked markets) where there is no choice of CCP. The risk issues are however the same in these last cases.

4. In lines 20-22 the sense is unclear: "there can be differences between the risk parameters ... as well as their reciprocal exposures". We assume that what is meant is both that there can be different parameters between those applied to a CCP's participants and to the other CCP, and that each CCP can use different parameters from each other for both purposes. This should be clarified.
7. The words "*In general CCPs should not make exceptions to their existing risk policies on margin coverage and on post-default backings for any market which they clear through a link.*" may have an ambiguous interpretation. We believe that they are not meant to prevent "exceptions" which are consistent with the specific role of a linked CCP (such as, but not limited to, the fact that "*No CCP is obliged to contribute to the other CCP's participants' default fund or other post default backing schemes*" as stated in the Access and Interoperability Guideline<sup>1</sup> (para. 84 second bullet), in order to contain the risk of spillover). We believe that their correct interpretation is in the spirit of "*no damage to risk management principles*" as stated in the Guideline (para. 82 third indent), which explicitly link Interoperability arrangements under the Code of Conduct with CPSS-IOSCO Recommendation 11. This principle has been further expanded in Standard 2 ("No competition on risk grounds") of the EACH Inter-CCP Risk Management Standards<sup>2</sup>.

## **RECOMMENDATION 13: GOVERNANCE**

### **C. Explanatory memorandum**

4. It should be made clear that the requirements detailed here cannot over-ride obligations on the managements and boards of CCPs that arise from statutory governance requirements, for example those applicable to listed companies, which apply to many European CCPs.

## **RECOMMENDATION 14: TRANSPARENCY**

### **B. Key issues**

1. The reference to "the balance sheet of the system's operator" should be replaced by "the latest audited balance sheet of the CCP".  
  
At the end of the paragraph, add the words "as defined under Recommendations 1-11."
3. This should be at least as prescriptive as the CPSS-IOSCO Recommendations which state that "The answers to the key questions of this report should be completed and disclosed."

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<sup>1</sup> [http://www.eachorg.eu/digitalAssets/49/49401\\_AccessInteroperabilityGuideline.pdf](http://www.eachorg.eu/digitalAssets/49/49401_AccessInteroperabilityGuideline.pdf)

<sup>2</sup> [http://www.eachorg.eu/digitalAssets/49/49417\\_EACH\\_Inter\\_CCP\\_Risk\\_Management\\_Standards\\_July\\_2008.pdf](http://www.eachorg.eu/digitalAssets/49/49417_EACH_Inter_CCP_Risk_Management_Standards_July_2008.pdf)

## **ANNEXES**

### **ASSESSMENT METHODOLOGY FOR SSSS**

#### **RSS4 (CENTRAL COUNTERPARTIES)**

##### **E 1 Key questions**

2. The reference to a “checklist for guarantee arrangements” is repeated.

#### **RSS8 (TIMING OF SETTLEMENT FINALITY)**

##### **E 1 Key questions**

1. d. Revocation should be allowed in the case of an instruction by a CCP as part of the exercising of the CCP’s default rules, subject to the system’s own settlement finality rules.

### **ASSESSMENT METHODOLOGY FOR CCPS**

#### **RCCP1 (LEGAL RISK)**

##### **E 1 Key questions**

2. Finality of transfers of commodities should be included.
4. This refers to “both” CCPs which more properly belongs in RCCP11.

##### **E 2 Assignment of an assessment category**

- 1 e. The CCP should have obtained, not just sought, designation under the SFD.

#### **RCCP2 (PARTICIPATION REQUIREMENTS)**

##### **E 1 Key questions**

2. In line 4 the reference to “the system” should be replaced by “the CCP”.

#### **RCCP4 (MARGIN REQUIREMENTS)**

##### **E 3 Explanatory notes**

1. In line 5: “gross margin” more typically refers to a method whereby the margin requirements for each individual trading entity, or customer, are aggregated at the clearing participant level, although each separate requirement may have offset long and short positions.

At the end, the implication is that the CCP should be aware of all of its participants’ liquidity arrangements. Being “cognisant” suggests merely that the CCP is aware of the need for such arrangements, and it should be clear that this is the requirement. Either the CCP should be aware of participants’ arrangements in all cases, which is

unreasonable, and impossible in relation to participants' customers, or should to be cognisant of the need, which seems acceptable.

### **RCCP5 (OTHER RISK CONTROLS)**

#### **E 1 Key questions**

1. The question should be asked, "In its evaluation of the largest potential exposure, does the CCP include risks arising from participants' further relation to the CCP, e.g. as intermediary, ... [as in C 2, and see above]?"

### **RCCP7 (CUSTODY AND INVESTMENT RISKS)**

#### **E 1 Key questions**

1. The CCP is required to verify that the holders of its collateral conform to the relevant ESCB-CESR or CPSS-IOSCO Recommendations. This should surely be a general requirement, equally, if not more, relevant under RCCP10. Unless the CCP itself has the authority to conduct such an assessment, it will however rely on the authorities having conducted, and published, such an assessment. The same principle should apply where a CCP wishes to link to another CCP.

### **RCCP11 (RISKS IN LINKS BETWEEN CCPS)**

#### **E 3 Explanatory notes**

1. This states that "in links organised in this manner" (i.e. where each CCP becomes a participant of the other), "exposures exist between the CCPs", implying that in a case where one CCP is a participant in the other, but not vice versa, only one CCP ever has an exposure to the other. This is not true: the difference, however would be that only one CCP provides full collateral for potential exposures to the other, which puts into question the regulatory status of the "CCP" that provides, but does not receive, this collateral.
2. This paragraph seems to derive from a description of some earlier types of links between derivatives exchanges and CCPs. A more general case is where each CCP becomes counterparty to its own participants, and each other, simultaneously: as in
3. which however goes on to state that "The linked CCPs participate in each other's systems as equals, necessitating agreement on a common risk management methodology on a product by product basis." Either a CCP is a participant in the other, as an equal of that other CCP's participants (again raising the question of that CCP's status), or each CCP is "equal" to the other in some sense and does not "participate" in the other's system. There has to be a degree of commonality in any counterparty relationship (e.g. that the same valuation process is used for positions), but there does not need to be, overall, "a common risk management methodology".

## **RCCP13 (GOVERNANCE)**

### **E 3 Explanatory notes**

2. The reference to a CCP being “wholly owned” should be extended to other forms of corporate control, as it is possible to exert influence over an entity without necessary wholly-owning it.

## **RCCP14 (TRANSPARENCY)**

### **E 1 Explanatory notes**

1. The reference to “the balance sheet of the system’s operator” should be replaced by “the latest audited balance sheet of the CCP”.

At the end of the paragraph, add the words “as defined under Recommendations 1-11.”

3. Analogous to the similar point in the CPSS-IOSCO Recommendations, the question “Have the answers to the key questions set out in this report been completed and disclosed?” should be asked.

### **E 2 Assignment of an assessment category**

1. c. As in the CPSS-IOSCO Recommendations, this should include “The answers to the key questions in this report are completed and disclosed.”