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CROSS-BORDER ISSUES CENTRAL COUNTERPARTIES AND CENTRAL SECURITIES DEPOSITORIES

TECHNICAL NOTE

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Contents Page

Glossary 3

Executive Summary 4

I. Introduction 5

II. Description of CCPs and CSDs in the EU 7

III. Main issues 12
A. Effectiveness of the Supervision and Oversight of CCPs and CSDs 12
B. Cooperation among Authorities 15
C. Crisis Management 18

IV. Recommendations 19

Table
1. Supervision and Oversight under EMIR and the Draft CSD Regulation 10

Box
1. Members of Supervisory College CCPs 16

Appendixes
I. Main Securities CCPs and CSDs in the EU 20
II. Statistics of Individual CCPs and CSDs in the EU 22

GLOSSARY

CCP	Central Counterparty
CDS	Credit Default Swap
CPSS	Committee on Payment and Settlement Systems
CSD	Central Securities Depository
EBA	European Banking Association
ECB	European Central Bank
EMIR	European Market Infrastructure Regulation
ESA	European Supervisory Authority
ESCB	European System of Central Banks
ESMA	European Securities and Markets Authority
EU	European Union
FMI	Financial Market Infrastructure
ICSD	International Central Securities Depository
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
MIFID	Markets in Financial Instruments Directive
MIFIR	Markets in Financial Instruments Regulation
MOU	Memorandum of Understanding
MTF	Multilateral Trading Facility
NCB	National Central Bank
PFMI	CPSS-IOSCO Principles for Financial Market Infrastructures
OTC	Over the Counter
RTGS	Real Time Gross Settlement System
SE	Stock Exchange
SFD	Settlement Finality Directive
SSM	Single Supervisory Mechanism
SSS	Securities Settlement System
TR	Trade Repository
T2S	TARGET2 Securities

EXECUTIVE SUMMARY[1]

1. **The adoption of the European Market Infrastructure Regulation (EMIR) and the legislative work on the draft Central Securities Depositories (CSD) Regulation are crucial for the creation of a single market for Central Counterparties (CCPs) and CSDs. A timely adoption of the CSD Regulation is encouraged as well as the development of recovery and resolution legislation.** The regulations reduce various sources of risks related to the cross-border offering of clearing and settlement services. In addition they aim to provide for a level playing field enhancing fair and efficient competition between CCPs and CSDs. The Commission is encouraged to develop EU legislation for recovery and resolution of CCPs and CSDs to ensure that recovery and resolution plans of CCPs and CSDs will work across borders in case of large market disruptions.

2. **The team supports the intention of the Commission to further the centralization of supervisory responsibilities.** The two international CSDs should be brought under the single supervisory mechanism (SSM). The two international CSDs should be among the first to be included under the SSM as a failure of one of these CSDs may be highly disruptive and the current supervision by national authorities is suboptimal. In case of an unforeseen bankruptcy of the international CSDs the national fiscal authorities may have insufficient resources for a bail out. Also, the international CSDs are subject to competitive pressures that may encourage competition on risk measures and prevent the further improvement of their risk management frameworks.[2] The cooperation between the national supervisors is considered not sufficient to contribute to financial stability.

3. **Resources of the European Securities and Markets Authority (ESMA) should be increased to adequately fulfill the new responsibilities required by EMIR.** As the accuracy of these models is essential to safeguard CCPs in extreme market circumstances the independency of the review of these models should receive appropriate attention. The national competent authorities and ESMA should ensure that skilled resources are available to enable the adequate validation of the complex risk models of CCPs, as part of their role in the validation process of these models.

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[1] This note was prepared by Froukelien Wendt, Senior Financial Sector Expert from the IMF Monetary and Capital Markets department, for the 2012 EU FSAP. Her analysis was based on background documentation, as well as meetings with the Commission, ECB and ESMA, relevant authorities in Belgium, France, Germany, the Netherlands and the U.K., and various CCPs, CSDs and other market participants.

[2] Competition between financial market infrastructures can be an important mechanism for promoting efficiency. Competition may prevent monopolistic pricing and encourage innovation. However, competition on risk measures and management may impede adherence to appropriate standards of safety and security and should be prevented as the stability of the financial system is at stake.

4. **National competent authorities bear the primary supervisory responsibilities for CCPs and CSDs to maintain safe and efficient CCPs and CSDs.** The participation of ESMA in the CCP colleges should contribute significantly to supervisory consistency and oversight. It is recommended to require the establishment of a cooperation framework for national supervisors for CSDs as well, given the current and potential cross border nature of CSDs in Europe. The rights of CCPs and CSDs to access other markets and infrastructures should be further developed in line with international standards. Cooperation among authorities is of key importance to ensure that EU interests are taken into account in the approval process of collateral measures taken by CCPs and international CSDs to protect themselves in the event of a major downgrade of one of the member states.

5. **Regulatory risks are apparent due to inconsistencies between the development of the legal and regulatory frameworks in the EU, the U.S. and elsewhere, following the mandatory clearing obligation for standardized derivative contracts.** Globally operating OTC derivative CCPs face regulatory uncertainty and inefficiencies, which may impede their ability to operate safe and efficient systems. Relevant regulators should give priority to the identification and mitigation of conflicts, inconsistencies and gaps between EMIR and other non-EU frameworks through bilateral and multilateral coordination.

6. **Central bank oversight should continue developing a macro view on the stability of CCPs and CSDs in the EU, taking into account monetary policy interests, with appropriate information sharing between central banks, including the European Central Bank (ECB).** The European System of Central Banks (ESCB) is encouraged to implement its plans for information sharing between national central banks and the ECB to support proactive, comprehensive and consistent analysis within the ESCB. The ECB Governing Council is encouraged to evaluate the effectiveness of the information sharing within the ESCB.

7. **EU crisis management procedures for financial market infrastructures should be further developed and tested.** ESMA and the ESCB are encouraged to agree on a crisis management framework that allows for immediate information sharing between all relevant authorities, CCPs, CSDs and other relevant systems and market participants. The functioning of the notification scheme under the settlement finality directive (SFD) should be reviewed as this proved to function insufficiently during recent bankruptcy's of participants. Tests should be conducted regularly to assess the functioning of the crisis management plans.

I. INTRODUCTION

8. **The main objective of this note is to identify cross-border risks related to CCPs and CSDs in the EU and recommend actions to further the safety and stability of the financial system.** The analysis is based on the concepts described in the relevant

international standards, e.g., the CPSS-IOSCO Principles for Financial Market Infrastructures (PFMI).[3] Other financial market infrastructures (FMIs), such as systemically important payment systems and trade repositories (TRs) are mentioned if relevant in the context of CCPs and CSDs.

9. **The analysis focuses on the effectiveness of the regulatory, supervisory and oversight frameworks for CCPs and CSDs in the EU as these are essential in promoting and maintaining financial stability.** CCPs and CSDs can vastly improve the efficiency, transparency, and safety of financial systems, but also concentrate systemic risk. If not properly managed they can be sources of financial shocks, such as liquidity dislocations and credit losses, or a major channel through which shocks are transmitted across domestic and international financial markets. The systemic importance of CCPs will increase with the implementation of the G20 reforms comprising the mandatory clearing of all standardized OTC derivatives. Therefore, the appropriate regulation, supervision and oversight of CCPs and CSDs are essential to reduce systemic risk.

10. **Cooperation between authorities within and outside the EU is critical to reduce the risks related to the cross border nature of clearing and settlement within the EU.** CCPs and CSDs are regulated, supervised and overseen by their national authorities. Given the increased interconnectedness between countries a lack of efficient and effective communication and consultation may result in various risks and inefficiencies, such as regulatory arbitrage and competition on risk management. Protection of national markets may result in an unlevel playing field between CCPs and CSDs in the EU, which is risky and inefficient and impedes the creation of a single market for securities and derivatives clearing and settlement.

11. **In this context crisis management arrangements between EU authorities are of key importance to adequately fulfill the various responsibilities authorities may have in relation to CCPs and CSDs in crisis situations.** Therefore, the note also analyses the existing crisis management frameworks of authorities of CCPs and CSDs in the EU, taking into account the lessons learned during recent defaults of for example Lehman Brothers and MF Global.

12. **The remainder of this note is structured as follows:** Chapter II provides an overview of CCPs and CSDs in the EU, describes their oversight and supervision framework, and outlines the main reforms. Chapter III discusses the following main issues: effectiveness of the oversight/supervision of CCPs and CSDs, cooperation between EU authorities, and crisis management. Chapter IV concludes with recommendations.

[3] Published in April 2012.

II. DESCRIPTION OF CCPS AND CSDS IN THE EU

Overview of securities and derivatives clearing and settlement landscape

13. **The objectives of the EU are to ensure a smooth functioning of the internal market for CCP and CSD services by increasing safety, ensuring a high level of investor protection, creating a level playing field and improving the efficiency of clearing and settlement in general.[4] In line with these objectives the European Commission (Commission) has drafted regulations covering CCPs and CSDs.** CCPs are covered by the European Market Infrastructure Regulation (EMIR) that has entered into force in August 2012, following its adoption by the European Parliament and the Council of ministers. As the EU aims to ensure that the G20 commitments on mandatory clearing of all standardized OTC derivative contracts are implemented it deems it essential that CCPs are safe and sound and comply at all time with strict requirements. CSDs are covered by the Commission's proposal for a CSD Regulation that is expected to be adopted by the European Parliament and the Council in the course of 2013 and come into force thereafter. Regarding CSDs the EU aims to harmonize the differences between settlement practices and increase the settlement efficiency.

14. **There are currently more than 20 CCPs in Europe, clearing a wide range of markets and products.** Appendix 1 provides an overview of the different CCPs clearing different trading platforms and settling in different CSDs. Appendix 2 provides for statistics. CCPs in the EU clear one or more assets classes, varying from financial and commodity derivatives to cash equities and bonds/repos. The instruments cleared can be traded on organized trading platforms as well as OTC. In many cases, such as in France, Germany, and the U.K., CCPs for securities have been developed from established CCPs for derivatives. Some CCPs are exchange-owned, for example in Germany and Italy, whereas others are independent (LCH.Clearnet Group) or combined with CSDs, as until recently in Eastern Europe. Where some CCPs only service their domestic market other CCPs provide clearing services for a range of EU markets.

15. **The EU hosts various OTC derivative CCPs**. The largest global CCP for interest rate swaps is the London based Swapclear. Swapclear was launched by LCH.Clearnet Limited in September 1999 and started clearing plain vanilla interest rate swaps in four major currencies. ICE Clear Europe, also based in London, has a global leading position in clearing credit default swaps (CDSs). Following the agreement reached at the G20 Pittsburgh Summit stating that all standard OTC derivative contracts should be centrally cleared, other CCPs have developed or extended their OTC derivatives offering, e.g., in France, Germany, and Sweden.

[4] As described in the introductory parts of EMIR and the draft CSD Regulation of March 2012.

16. **There are more than 30 CSDs in the EU.** Historically CSDs have been separately developed for equity markets and for government bond markets. For the last 20 years, many central banks in the EU have shifted their CSD activity for government securities to the private sector, creating one CSD per country that handles all types of securities. Currently, some CSDs are exchange-owned as in Germany, Italy, Poland and Spain. Some CSDs are owned by the private sector, whereas some are owned by the public sector, as in Hungary. Some are listed companies or belong to listed companies, whereas others are user-owned. Where some CSDs service their domestic markets others are cooperating across borders, either by the merger of national CSDs (Euroclear) or by optimizing link arrangements (Link Up Markets).

17. **Two international CSDs (ICSDs) are located in the EU offering global settlement, custody and collateral services.** The ICSDs, which are Euroclear Bank and Clearstream Banking Luxembourg, were created in the 1970s to settle Eurobonds. Over the years, ICSDs have extended their scope to all types of internationally-traded financial instruments, including equities and investment funds. Under their respective banking licenses the ICSDs provide cash accounts and credit lines to their participants to facilitate settlement. The ICSDs compete with each other as well as with global custodians. Several global custodians are currently considering applying for a CSD license to increase their services to securities settlement in addition to their asset services. Bank of New York Mellon has been the first to apply in the beginning of 2013.

18. **The EU's focus on financial stability and the reduction of risk has further increased, whereas more emphasis was placed on efficiency before the crisis.** As from 2006 changes in the EU legal and regulatory framework, such as the Markets in Financial Instruments Directive (MiFID) and the Code of Conduct for securities clearing and settlement, led to increased competition between cash trading platforms, clearing and settlement institutions. The MiFID abolished concentration rules and encouraged the proliferation of alternative execution venues, primarily Multilateral Trading Facilities (MTFs). In order to serve the MTFs, new CCPs entered the market, such as EMCF and EuroCCP.

19. **Competition in the cash market led to significant cuts in trading and clearing fees and ultimately in an interoperability arrangement between four CCPs for the clearing of securities transactions at various trading platforms.** Interoperability between the CCPs EMCF, EuroCCP, LCH.Clearnet Limited and SIX X-Clear allows for access to various trading platforms via one CCP. Positions will be netted across trading platforms and clearing members no longer need to deposit collateral at more than one institution.

20. **A recent trend is the re-verticalization of infrastructures, where exchanges hold the CCP as a subsidiary rather than conduct business with a CCP as a separate company.** In the U.K. the derivatives exchange NYSE LIFFE is developing its own CCP, in order to provide the services that were so far delivered by the CCP LCH.Clearnet Group.

Similar decisions were taken earlier by ICE Clear and the London Metal Exchange. The London Stock Exchange awaits the decision of the U.K. Office of Fair Trading to buy a majority stake in LCH.Clearnet Group Limited.

Overview of the regulatory, supervisory and oversight framework

21. **EMIR provides for the regulatory and supervisory framework for CCPs.** EMIR's text came into force on August16, 2012. In September 2012 ESMA delivered its draft technical standards to the European Commission for endorsement. It is expected that they will come into force by early April 2013, subject to the approval of the European Parliament and the Council. EMIR is also the relevant EU legislation for TRs and OTC derivative markets by providing the framework for implementing the mandatory clearing agreement of the G20. EMIR includes i) common rules for CCPs, ii) the introduction of a passport for CCP services, iii) a clearing obligation for eligible OTC derivatives with measures to reduce counterparty credit risk and operational risk for bilaterally cleared OTC derivatives, iv) a reporting obligation for derivatives to TRs, and v) rules on the establishment of interoperability between CCPs clearing cash markets. EMIR allows third countries to provide clearing and TR services in the EU provided the legal and supervisory regime in their country provides for an effective equivalent system for the recognition of CCPs under foreign legal regimes.

22. **It is the Commission's intention that the draft CSD Regulation will provide for the regulatory and supervisory framework for CSDs.** In March 2012 a draft proposal for CSD regulation has been passed to the European Parliament and the Council of the European Union for negotiation and adoption under the co-decision procedure. The proposal introduces common standards across the EU for securities settlement and CSDs as well as a passport regime.

23. **Under the new EU regulations the national authorities remain the competent authorities for CCPs and CSDs, with new roles for ESMA and the ESCB.** Table 1 outlines the responsibilities as envisaged under the new regulations. Each member state shall designate a competent authority that is responsible for the authorization and supervision of a CCP or CSD established in its territory.[5] The CCP and CSD have to comply with all the requirements laid down in the respective EU regulations. Authorized CCPs and CSDs will be granted passport rights to provide their services in other member states.

24. **The responsibilities of ESMA increase under EMIR and the draft CSD Regulation.** The new competences of ESMA include the development of binding technical standards in close consultation with the members of the ESCB. ESMA shall fulfill a coordination role between competent authorities and across supervisory CCP colleges to

[5] The members of the ESCB and other national or public bodies are exempted from the authorization and supervision requirements. Central banks shall immediately inform ESMA of any CSD that they operate.

build consistent supervisory practices and eventually settling disagreements between authorities. ESMA will have increased emergency powers. On an annual basis ESMA shall conduct a peer review analysis of the supervisory activities of all competent authorities and initiate and coordinate EU-wide assessments of the resilience of CCPs. ESMA should engage in cooperation arrangements with third country authorities before ESMA has recognized a CCP or CSD from a third country.

Table 1. EU: Supervision and Oversight under EMIR and the Draft CSD Regulation

	Authorization, Supervision, and Regulation	Oversight
CCPs (expected as from April 2013)	A CCP is authorized by the competent authority of the member state in which the CCP is established, having obtained the opinion from the college for that CCP. Supervision is conducted by the competent authority of the member state in which the CCP is established, in cooperation with the college for that CCP, which includes ESMA in a non-voting capacity. ESMA has authority to develop binding technical standards under EMIR, which have to be adopted by the Commission.	Typically the national central bank in which the CCP is established, either as competent authority of the CCP or as member of the college. The central banks of issue of the most relevant EU currencies of the financial instruments cleared will also be members of the college.
CSDs/SSS (proposed CSD regulation of July 3, 2012)	A CSD is authorized and supervised by the competent authority of the member state where it is established, in close cooperation with other relevant authorities, including relevant members of the ESCB. Before granting authorization the competent authority has to consult with competent authorities of other member states if the CSD is a subsidiary of or belongs to the same group as a CSD authorized in another member state. ESMA has the authority to draft, in consultation with the members of the ESCB, binding technical standards under the CSD regulations, which have to be adopted by the Commission.	Typically the national central bank in which the CSD is established, either as competent authority of the CSD or as one of the relevant authorities that have to be consulted.

Source: EMIR, draft CSD Regulation, Eurosystem Oversight Annual Report 2011.

25. **EMIR and the draft CSD Regulation recognize the role of the ESCB in the supervision and oversight of CCPs and CSDs.** The increased role for the ESCB includes participation in the CCP colleges as overseer and central bank of issue. ESCB is also involved in the drafting of technical standards, guidelines and recommendations, although ESMA has the final responsibility. In addition, the members of the ESCB are involved in the authorisation of CCPs, the supervision of CCPs and CSDs, the recognition of third country CCPs and the approval of links.

26. **Other relevant directives in relation to CCPs and CSDs in the EU are the SFD and the collateral directive.** The SFD contains provisions to reduce the risk linked to the insolvency of a participant of FMIs. The SFD has been adapted to include lessons from the 2008 financial crisis, including provisions to ensure consistency with regard to the moment of entry of a transfer order into a system and irrevocability for interconnected systems. The collateral directive contains provisions related to the enforceability of collateral arrangements to limit contagion effects in the event of default by a participant of the FMI.

Recent reforms and reforms scheduled for the near future

27. **Foreseen legislative initiatives of the Commission related to CCPs and CSDs are:**

- Securities Law Legislation, which aims to ensure that investors have full control over their securities and give lenders confidence in their claim to securities collateral. It will focus on addressing the question of "who owns what" in order to address threats that have been identified to financial stability and investor protection. It looks at the legal, operational, and economic challenges involved in holding, buying, selling, and lending securities. This is especially relevant for addressing the securities financing aspects of shadow banking. The initiative will also consider how to improve the exercise of rights flowing from securities for investors.

- Consultation on a possible recovery and resolution framework for financial institutions other than banks, which has been issued by the Commission in October 2012 and includes recovery and resolution issues for CCPs and CSDs.

28. **TARGET2Securities (T2S) is a project of the Eurosystem aiming to centralise the settlement operations on a single pan-European platform, thereby further integrating the post trade market in the EU.** T2S will be a single IT platform for securities settlement in Europe, accommodating both the market participant's securities accounts, held at either one CSD or at multiple CSDs, and its central bank cash accounts in TARGET2. The main objective is to reduce cross-border settlement fees, which are on average higher than domestic fees, through a single IT platform and standardized communication protocols. The T2S project was initiated in 2006 and is currently under development. Based on the latest announcements it is scheduled to go-live in 2015. The IT platform will be built, owned and operated by the ECB and 17 national central banks in the euro area (Eurosystem). So far 24

national CSDs have signed up to join T2S, however the central banks in the U.K., Czech Republic and Sweden have announced not to participate.

III. MAIN ISSUES

A. Effectiveness of the Supervision and Oversight of CCPs and CSDs[6]

Issues related to regulation, supervision, and oversight

29. **The EU regulations for the authorization, regulation and supervision of CCPs and CSDs should significantly improve the safety, efficiency and level playing field in the EU post-trade market as they provide common standards across the EU.** These regulations should mitigate the risks and inefficiencies resulting from the diversity of national rules and supervisory frameworks. Conflicts of law may result in legal risks, whereas inconsistencies in the financial risk management of cross border clearing may cause credit and liquidity risks. Differences in operational procedures may threaten cross-border operational reliability and contagion between cross-border operating systems may entail systemic risk. The regulations support cooperation between supervisors, which is essential during crisis situations to react swiftly and accurately, as became apparent during the Lehman and other defaults of participants of FMIs. In the absence of a European passport CCPs and CSDs based in one member state must comply with the diverse requirements of the different national supervisors in other states, which may paralyse cross-border clearing and settlement and entail significant costs.

30. **Inconsistencies do however exist between the legal and regulatory frameworks in the EU, the U.S., and elsewhere regarding OTC derivatives clearing, threatening the safety and efficiency of OTC derivatives clearing.** Following the G20 agreement to mandatorily clear all standardized OTC derivatives the EU, the U.S., and other relevant authorities have developed requirements for (OTC derivatives) clearing in parallel.[7] Despite regular communication and coordination between the U.S. and EU authorities, relevant differences remain, for example in relation to the segregation and portability requirements and requirements for the calculation of margin. Other differences relate to extraterritoriality and recognition of CCPs located outside their own territory. It is important that regulators from the EU, the U.S., and other relevant countries continue bilateral and multilateral coordination to reduce these inconsistencies, and develop mechanisms based on the mutual recognition of their respective regulations in order to limit as much as possible conflicts, inconsistencies and duplication of rules.

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[6] Based on the concepts in the PFMI Responsibilities A to D for authorities of FMIs.

[7] As included in EMIR for the EU and the Dodd Frank Act for the U.S.

31. **The Commission is encouraged to develop legislation for the recovery and resolution of CCPs and CSDs to have safe and efficient CCPs and CSDs.** Measures should be taken to ensure that recovery and resolution plans will work across borders in case of large market disruptions as described in the recovery and resolution plans of CCPs and CSDs.

32. **Under the new regulations the competent authorities will have legal powers to obtain timely information and induce change.** The competent authorities are able to apply administrative sanctions and measures to CCPs and CSDs, designated credit institutions, the members of their management bodies and any other persons who effectively control their business as well as to anybody who is held responsible for a breach. The competent authorities have the power to impose at least the following administrative sanctions and measures: public statements, withdrawal of the authorizations, dismissal of the members of the management bodies of the institutions responsible for a breach, and administrative pecuniary sanctions.

33. **ESMA will have sufficient legal powers to fulfill its duties.** ESMA may, at any time, request information of the competent authority about the compliance of the CCP or CSD with the conditions under which the authorization is granted. ESMA participates in CCP colleges, which enables ESMA to ensure consistency in supervisory practices. ESMA will have no voting rights on the opinions of the college, but in case of disagreement one competent authority is needed to escalate the issue to ESMA and ESMA's opinion will be binding. ESMA can issue level 3 guidelines addressed to authorities on various matters. ESMA has made a head start by preparing the drafting of several protocols regarding the functioning of the colleges, a risk assessment framework, and the exchange of information and crisis management procedures. ESMA also has the power to withdraw the recognition of a third country CCP and CSD.

34. **ESMA should quickly extend its resources to carry out responsibilities.** ESMA's role is very important in safeguarding the stability of the financial sector and of high political priority and should therefore be adequately resourced. In practice current resources are insufficient to develop and execute all new tasks in an adequate way. The national competent authorities and ESMA should ensure that skilled resources are available to enable the adequate validation of the complex risk models of CCPs, as part of their role in the validation process of these models.[8]

35. **The legal basis for the ESCB member's involvement in the supervision of CSDs is important as central banks have an intrinsic interest in the safe and efficient**

[8] EMIR article 49 specifies that a CCP shall obtain an independent validation of its models and parameters and inform its competent authority and ESMA of the results of the tests performed and shall obtain their validation before adopting any significant change to the models and parameters.

functioning of securities settlement systems, because of their relevance to financial stability. Securities are used to carry out monetary policy through open market operations. Difficulties in securities settlement systems could disrupt the ability of the central bank to implement monetary policy effectively. Securities settlement systems are essential for the timely delivery of collateral for payments and other purposes.

36. **Central bank oversight should continue developing a macro view on the stability of CCPs and CSDs in the EU, taking into account monetary policy interests, by appropriate information sharing between central banks and the ECB.** The ESCB is in the unique position to further develop a financial stability view on CCPs and CSDs in the EU in addition to the supervisory activities of national competent authorities and ESMA. In doing so the ESCB could take into account the relevance of CCPs and CSDs for monetary policy operations and related collateral issues. The ESCB is encouraged to implement plans for information sharing between national central banks and the ECB by establishing a dedicated information sharing group for ESCB representatives that participate in colleges for CCPs and eventually CSDs. This is relevant to complement the current decentralized organization of oversight[9] with proactive, comprehensive and consistent analysis. The ESCB's resources need to be increased to facilitate the new coordination tasks as well as the increased duties to represent the Eurosystem as central bank of issue in supervisory colleges. The ECB Governing Council is encouraged to evaluate the effectiveness of the information sharing within the ESCB.

37. **Laws, regulations and standards for CCPs and CSDs are publicly disclosed, but the presentation of information on the ESMA website could be improved.** EMIR and the draft technical standards are available on Internet as is the draft CSD regulation. ESMA will be a center of relevant information on EU supervision of CCPs and CSDs. Regulations require ESMA to publish a range of lists and registers on its website, such as lists of competent authorities, authorized and recognized CCPs and CSDs, including services, products, branches and links. ESMA shall also publish its opinions on its website. In practice the website of ESMA is not very accessible, assuming a high level of knowledge on clearing and settlement topics and lacking a clear presentation of the information.

38. **The Eurosystem discloses its oversight policies on its website.** Annual oversight reports provide a description on oversight activities. The Eurosystem has clarified its oversight role in a policy statement called 'Eurosystem oversight policy framework' that is regularly updated. The latest version covers the objectives of oversight, the role of the Eurosystem, the legal basis, scope, activities, standards and cooperative arrangements.

[9] Oversight on securities and derivatives clearing and settlement systems is typically conducted by national central banks with a limited role for the ECB as standard setter.

39. **The new EU regulations are based on the CPSS-IOSCO Principles for FMIs.** The provisions of the new regulations, including the technical standards, follow the existing recommendations developed by CPSS-IOSCO and ESCB-CESR. While EMIR was drafted in parallel to the PFMI, the draft CSD Regulation benefits from the finalized international standards.

B. Cooperation among Authorities[10]

40. **Cooperation among authorities of CCPs will receive a legal underpinning in EMIR.** Today, several supervisory colleges for CCPs are in place to coordinate cross border supervision and oversight.[11] The colleges are governed by memorandums of understanding (MOUs). The current pile of MOUs between authorities of cross border operating CCPs will be replaced by EMIR that requires the CCP's competent authority to establish, manage and chair a college for the authorization and supervision of CCPs. The college should be involved in the risk management model validation and interoperability arrangements with other CCPs and related risk management measures. The establishment and functioning of the college will be based on a written agreement between all of its members. EMIR provides college members with the power to determine the college's decision-making procedures, including detailed rules on voting procedures.

41. **The colleges will be composed of various types of authorities representing various public interests.** Each college shall consist of members representing ESMA, the national competent authority supervising the CCP and other member states' competent authorities supervising entities which might be impacted by that CCP's operations. Colleges can have a limited size, for locally operating CCPs, or a large size for cross-border operating CCPs, requiring explicit organizational and chairing skills of the national authorities. Box 1 outlines the EMIR prescriptions for the composition of the CCP colleges. EMIR prescribes that the college should vote in accordance with the general principle whereby each member has one vote, irrespective of the number of functions it performs.

42. **The EMIR colleges are expected to allow for an effective representation of EU interests, while ESMA is expected to contribute significantly to supervisory consistency and oversight.** EMIR sufficiently underpins the role of the colleges and of ESMA to justify the expectation that the colleges will ensure consistent authorization, supervision and oversight of CCPs within the EU. This will contribute to compliance of CCPs with the requirements of EMIR and subsequently to financial stability. It will have to be assessed if the combination of the decentralized structure of CSDs and CCPs' supervision and the

[10] Based on the concepts in the PFMI Responsibility E for authorities of FMIs.

[11] Colleges exist for LCH.Clearnet SA, LCH.Clearnet Group Limited and EMCF.

coordination function of colleges and ESMA delivers an efficient supervision of these infrastructures or whether a more centralized structure should be further explored.

Box 1: Members of Supervisory College CCPs

A college for CCP authorization and supervision should consist of :

- ESMA;
- the CCP's competent authority;
- the competent authorities responsible for the supervision of the clearing members of the CCP that are established in the three member states with the largest contributions to the default fund of the CCP on an aggregate basis over a one-year period;
- the competent authorities responsible for the supervision of trading venues served by the CCP;
- the competent authorities supervising CCPs with which interoperability arrangements have been established;
- the competent authorities supervising CSDs to which the CCP is linked;
- the relevant members of the ESCB responsible for the oversight of the CCP and the relevant members of the ESCB responsible for the oversight of the CCPs with which interoperability arrangements have been established; and
- the central banks of issue of the most relevant union currencies of the financial instruments cleared.

Source: EMIR Article 18

43. **It is necessary that a comprehensive framework for cooperation between national supervisors be established for CSDs as well.** The draft CSD regulation does not prescribe a supervisory college or another comprehensive cooperation framework between national supervisors of CSDs.[12] It is recommended to require the establishment of such a cooperation framework for national supervisors of CSDs in the foreseen CSD Regulation, building on the example of CCP colleges. Colleges or other types of comprehensive cooperation frameworks will oblige national supervisors to cooperate on a broader range of topics than currently requested under the draft CSD Regulation. Also, authorities have more means to influence decision making or refer to ESMA, which is important in the case of CSDs that provide cross border settlement services. With the development of the Securities Law Legislation potentially more CSDs will be of interest to authorities from other member states.

44. **The two ICSDs, and any systemically important CSD providing banking services, should be included in the list of eligible institutions for the SSM. The cooperation framework for the supervision of CSDs with a banking license should include arrangements for cooperation among the ECB, ESMA and national supervisory authorities.** The banking supervision of the two international CSDs in the EU should be

[12] Although the competent authority is required to cooperate closely with ESMA and various other authorities in certain cases.

centralized as the relevant national fiscal authorities may have insufficient resources to facilitate an eventual bail out. Centralized banking supervision should reduce the chance that competitive pressures will result in competition on risk measures. It should provide for a level playing field and ensure enhancements to the credit and liquidity risk management frameworks of the ICSDs. As the ICSDs will be supervised by different authorities for their banking and CSD activities a cooperation framework should be established to coordinate among these different authorities, i.e., among the ECB as banking supervisor and ESMA, the ESCB and the national competent authorities responsible for the supervision and oversight of CSD activities.

45. **Cooperation among authorities is also necessary to support the establishment of a back up arrangement for settlement operations in case a CSD with a banking license goes bankrupt.** Ring fencing of settlement accounts from any risk-taking ancillary services will be beneficial from a systemic risk point of view and is in line with the PFMI, e.g., Principle 3 regarding plans for recovery and orderly winding down of operations. A CSD that holds a banking license is exposed to credit and liquidity risks and may be subject to bankruptcy procedures. In that case the CSD could have a back up arrangement in place with another provider of cash accounts to allow for a swift continuation of settlement operations. It is preferred that such a back up provider of cash accounts has a limited risk profile as well. The current requirement in the draft CSD Regulation to place cash accounts in a separate legal entity could be a solution to secure the protection of settlement operations, but should avoid that the backup provider of cash accounts has a risk profile which increases risks for the securities account holders. The requirement to hold cash accounts in a separate legal entity may discourage current CSDs without a banking license to request one under the new regulation.

46. **Cooperation between authorities is crucial in the event of a default or downgrade of one or more countries in the EU and will help to avoid that measures in one member state disrupt markets, CCPs or CSDs in other member states.** The default or downgrade of a country may heavily impact the value of specific government securities held as collateral by CCPs and ICSDs and subsequently leave the FMIs with insufficient coverage. Wrong way risk should be mitigated as clearing participants holding the securities may default and cause losses to the CCP or ICSD. Simultaneously, pro-cyclicality should be limited by seeking for a careful balance between protecting the CCP and avoiding the exacerbation of financial problems of participants and markets. Authorities should monitor and analyze such a situation in a cooperative way and pursue the interests of the EU as a whole.

47. **With the re-verticalization of infrastructures the rights of CCPs and CSDs to access other markets and infrastructures should gain particular attention to further a level playing field.** Interoperability between cash CCPs can be a useful tool to enhance the efficiency of the clearing market, but may also threaten the market share of incumbent CCPs. Trading platforms that also own a CCP can refuse access of other CCPs to its trading

platform and eventually CSDs on discriminatory grounds. CSDs should also gain non-discriminatory access to CCPs. Restrictions to access rights as prescribed in EMIR, and potentially the Markets in Financial Instruments Regulation (MIFIR) and the CSD Regulation, should be exclusively risk based (excluding business risk) and publicly disclosed. Competitive distortions should be avoided.[13]

C. Crisis Management[14]

48. **Cross border crisis management for CCPs and CSDs is essential to help minimize losses and maintain confidence of participants in CCPs and CSDs.** The authorities' objective should be to have a framework for timely, complete information to all relevant stakeholders, providing transparency on the size and severity of the crisis. This will support authorities in fulfilling their respective regulatory, supervisory and oversight mandates and act in a concerted way if needed. It may also enable CCPs, CSDs and their participants to take timely action to liquidate positions and anticipate remaining settlements. Inadequate cooperation during times of market stress and crisis situations can impede significantly the work of relevant authorities.

49. **EU legislation recognizes the need for crisis management arrangements for authorities of CCPs and CSDs.** Information sharing among authorities is covered in several EU Directives. EMIR, the draft CSD Regulation and the SFD specify ESMA's role in times of crisis. Other information sharing requirements are laid down in the banks winding up directive, the market abuse directive and the capital requirements directive. The framework prescribes information sharing with known creditors and the sharing of information between designated competent authorities in the EU.

50. **The SFD notification scheme did not work properly during recent defaults of major participants and should be reviewed.** Both market participants as well as public authorities perceived information sharing on a defaulting market participant not always as timely and comprehensive.[15] Awareness should be raised among designated authorities under the SFD regarding their obligations in case of a crisis and tests should be conducted. ESMA should play a leading role in this regard together with the ESCB. The SFD notification scheme should include all relevant authorities, including the ECB in its role as lead overseer of TARGET2 and EURO1.

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[13] See PFMI Principle 18.

[14] Based on the concepts in the PFMI Responsibility E for authorities of FMIs, Principle 13 and Principle 17.

[15] See for example ECB, Report on the lessons learned from the financial crisis with regard to the functioning of European financial market infrastructures, April 2010.

51. **Colleges, chaired by respective competent authorities, ESMA and the ESCB are encouraged to continue with the development of a crisis management framework to deal with a potential failure of a CCP, CSD or other relevant FMI.** The added value of this crisis management framework in addition to the SFD is that the information sharing can precede the actual default and that all EU competent authorities and central banks are involved. The plan should be regularly tested and updated.

IV. RECOMMENDATIONS

52. **Recommendations on the regulation, supervision and oversight of FMIs:**

- Early passage of the EMIR technical standards is recommended to provide the supervisory authorities, ESMA and the ESCB with all tools to implement the new requirements for CCPs and establish national colleges.

- Early adoption of the CSD Regulation is recommended to provide national authorities, ESMA and the ESCB with the legal basis for raising the bar for CSDs.

- The Commission is encouraged to develop legislation for the recovery and resolution of CCPs and CSDs.

- It is of critical importance that regulators from the EU, U.S.and other relevant countries continue bilateral and multilateral coordination to reduce gaps and inconsistencies between legal and regulatory frameworks for OTC derivatives clearing as a matter of urgency.

- ESMA resources need to be significantly increased to enable ESMA to adequately accomplish its extended duties.

- The ESCB overseers should improve their information sharing regarding CCPs and CSDs and aim for the development of a comprehensive macro view on the financial stability of CCPs and CSDs in the EU.

- The ESCB should be sufficiently staffed to fulfill coordination and information sharing tasks with regard to CCPs and CSDs and ensure efficiency in the representation of the Eurosystem in supervisory colleges.

53. **Recommendations on cooperation between authorities:**

- Euroclear Bank and Clearstream Banking Luxembourg should be amongst the first institutions taken into SSM supervision as the current regulatory and supervisory structure is insufficient to ensure financial stability. The SSM supervision should relate to the banking activities while the CSD activities should be supervised by ESMA and national supervisors under the envisaged CSD Regulation.

- The ECB, ESMA and supervisory authorities should develop a cooperation framework for CSDs that are subject to banking supervision under the SSM as well as supervision under the CSD Regulation.

- The CSD Regulation should include a requirement for colleges or other comprehensive cooperation frameworks for supervisors of CSDs.

- Securities accounts within a CSD, that also provides banking services, should be ring fenced to protect settlement operations in case of a crisis, although additional measures remain needed to ensure continued settlement operations.

- It is essential that authorities cooperate in the event of a potential major downgrade of one of the member states, to optimize the protection of CCPs and ICSDs in the EU through collateral.

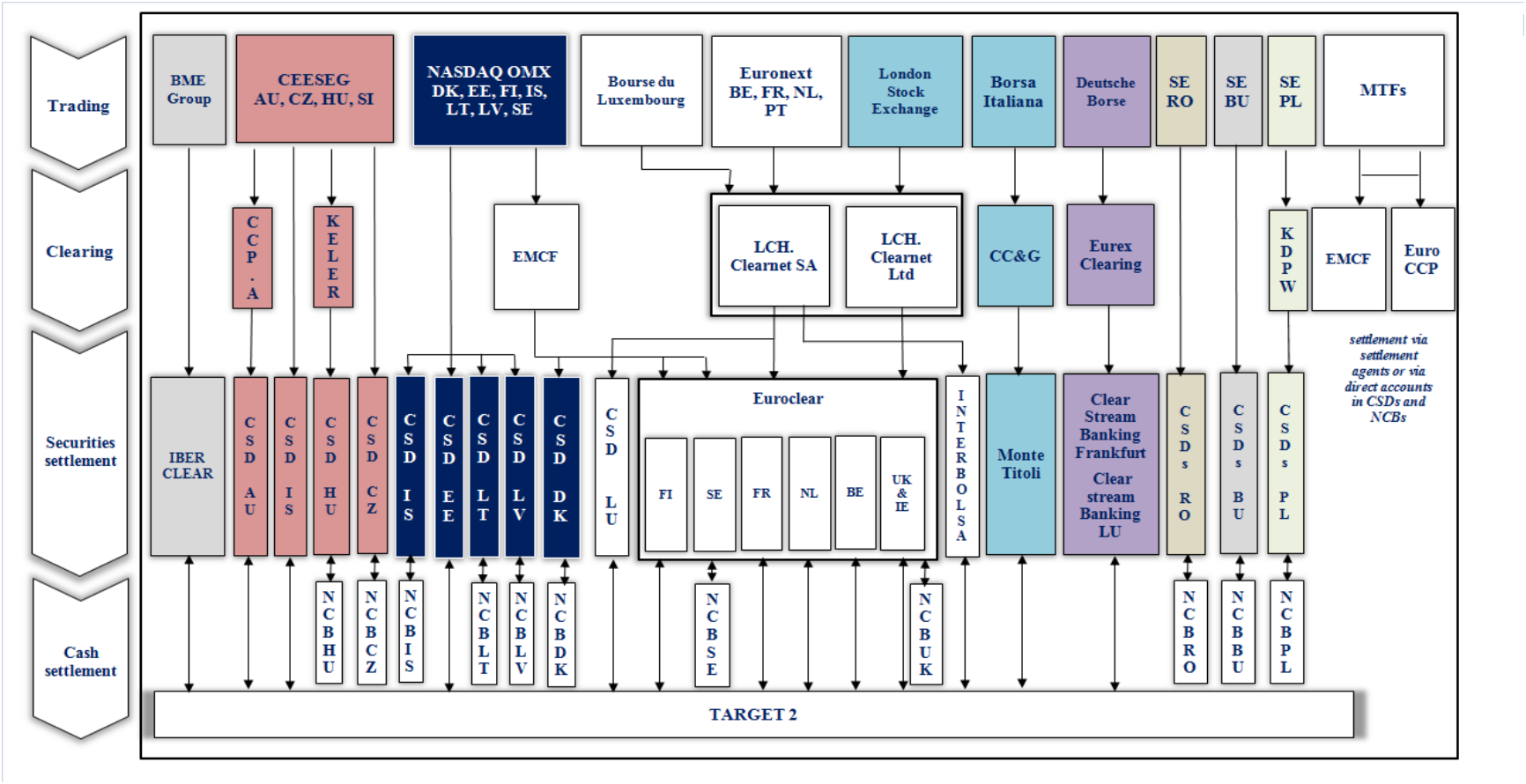
- The Commission should pay particular attention to the drafting of access rights for CCPs and CSDs in the MIFIR and CSD regulation. Access criteria should be non-discriminatory and risk based (excluding business risk), contributing to a level playing field for the offering of CCP and CSD services**.**

54. **Recommendations on crisis management procedures:**

- Crisis management arrangements between ESMA and the ESCB should be further developed and tested.

- The SFD notification regime should be reviewed, standardized and enhanced, with the inclusion of all relevant authorities, including the ECB as overseer of TARGET2 and EURO1.

Appendix I. Main Securities CCPs and CSDs in the EU[16] [17]



[16] This simplified overview does not include all existing European infrastructures. Nor does it show horizontal links.

[17] EMCF clears the MTFs BATS Chi-X, Nasdaq OMX, Quote, and Burgundy; EuroCCP clears the MTFs NYSEARCA, Turquoise, and Smartpool

Appendix II. Statistics of Individual CCPs and CSDs in the EU

Main CSDs		
System	**Description**	**Statistics (value of delivery instructions, 2011)**
Clearstream	Clearstream: an international central securities depository (ICSD) and CSDs of Germany and Luxembourg.	CBL: €74 trillion CBF: €80 trillion
Euroclear S.A.	Euroclear Bank: ICSD for Eurobonds and other international securities.	€367 trillion
	ESES CSD: The Belgian, Dutch and French CSDs operate one common platform	Euroclear BE: €0.6 trillion Euroclear Nederland €5 trillion Euroclear France €146 trillion
	Euroclear U.K. & Ireland: CSD for U.K.and Ireland	€150 trillion
	Euroclear Sweden: CSD for Sweden Euroclear Finland: CSD for Finland	€11 trillion € 0.5 trillion
Monte Titoli	CSD for trades executed on the Italian trading platforms. Part of LSE Group.	€72 trillion
Iberclear	Spanish CSD for trades executed on the Spanish stock exchanges, Latibex and for debt transactions.	€88 trillion

Source: ECB.

Main CCPs—Cash Markets[18]		
System	**Description**	**Statistics (value of cash securities transactions, 2011)**
CC&G	CCP clearing for the Italian markets.	€3 trillion
CCP Austria	CCP for Austrian cash and derivative markets	€0.08 trillion (in 2010)
EUREX Clearing	CCP incorporated in Germany, offering clearing services for derivatives and equities traded on German markets.	€3 trillion
LCH.Clearnet Limited	Part of the LCH.Clearnet group. Clears equities and derivatives for various platforms, including the London Stock Exchange. Swapclear is part of LCH.Clearnet Limited and is the largest CCP for interest rate swaps globally.	€4 trillion (in 2009)
LCH.Clearnet SA	Part of the LCH.Clearnet group. Clears equities and derivatives for the Euronext markets in Belgium, France, the Netherlands and Portugal; government bonds for MTS Italy; equity for Bourse de Luxembourg and several electronic trading platforms	€6 trillion
EuroCCP	CCP incorporated in the U.K.; clearing for 17 markets in Europe and the US.	NA
European Multilateral Clearing Facility (EMCF)	CCP incorporated in the Netherlands; clearing for 19 European markets through nine different exchanges and trading platforms.	€6 trillion
KELER CCP	CCP for Hungarian market	NA

Source: ECB.

[18] No consistent statistics are available on cleared values of exchange traded and/or OTC traded derivatives per CCP. CC&G, Eurex Clearing, LCH.Clearnet Limited, LCH.Clearnet SA, and MEFF clear substantial amounts of derivatives transactions. LCH.Clearnet Limited and U.K. ICE Clear Europe clear substantial amounts of OTC derivatives.