



EuroCCP's account segregation and portability offering and disclosure under article 39(7) of EMIR

Issuing department: Legal and Compliance
Reviewed: April 2018
Next review: April 2019

1. Introduction

This document provides information on EuroCCP's account segregation and portability offering under EMIR¹ and is a disclosure pursuant to article 39(7) of EMIR.

Capitalised terms used herein shall have the meaning given thereto in EuroCCP's Clearing Rules which can be found on EuroCCP's website (<https://euroccp.com/document/euroccp-clearing-rule-book/?wpdmdl>; <https://euroccp.com/home/participants-centre/documentation/#regulations>).

2. EMIR requirements

Article 39 of EMIR requires CCPs to:

- *"keep separate records and accounts enabling each clearing member to distinguish in accounts with the CCP the assets and positions of that clearing member from those held for the accounts of its clients ('omnibus client segregation')";* and to
- *"offer to keep separate records and accounts enabling each clearing member to distinguish in accounts with the CCP the assets and positions held for the account of a client from those held for the account of other clients ('individual client segregation').".*

And requires clearing participants to offer their clients:

- *"...at least, the choice between omnibus client segregation and individual client segregation."*

Furthermore article 48 of EMIR requires CCPs to:

- *"...at least, contractually commit itself to trigger the procedures for the transfer of the assets and positions held by the defaulting clearing member for the account of its client(s) to another*

¹ Regulation (EU) No 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories
<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:EN:PDF>

clearing member designated by (all of) those client(s)...”; and to

- *...use client collateral exclusively to cover the positions held for their account. Any balance owed by the CCP after the completion of the clearing member’s default management process by the CCP shall be readily returned to those clients when they are known to the CCP or, if they are not, to the clearing member for the account of its clients.*

3. EuroCCP’s account offering

There are three account types available at EuroCCP:

1. House account
2. Omnibus client account
3. Individual segregated client account

Clearing Participants that only clear their own propriety positions will only have a house account. In this account their own positions will be registered. Clearing Participants that also clear on behalf of their clients will also have omnibus client accounts and/or individual segregated client accounts.

4. Segregation options for Clearing Participants and their clients

Under EMIR, the house account and omnibus client account of a Clearing Participant must be segregated. Clients of Clearing Participants will also have the option to hold their assets in fully segregated individual client accounts, separate from other client accounts. In a individual client account, the assets are not commingled with the assets of the other clients of the clearing participant (as is the case in the omnibus client account) nor with the assets of the Clearing Participant.

The implications of choosing for omnibus accounts or individual segregated accounts are detailed further below. For a schematic overview, reference is made to the diagram attached hereto as Appendix A.

EuroCCP has separate collateral accounts for each separate position account. The collateral is there to cover for any losses EuroCCP may incur due to market movements from the moment of a default of a clearing participant until the moment of closing the positions cleared for that Clearing Participant. The collateral accounts are discussed further below under paragraph 7 (*Segregation of client collateral accounts*).

5. Principal to principal relationship

EuroCCP maintains a principal to principal relationship with the Clearing Participants, as is customary for CCPs both in common law and civil law jurisdictions. The Clearing Rules of EuroCCP do not create a contractual relationship between EuroCCP and the clients of the Clearing Participant.

Consequently, from a Dutch legal perspective which is the law governing the Clearing Rules of EuroCCP, the designation of position accounts and collateral accounts in the books of EuroCCP as segregated omnibus client accounts or individual segregated client accounts is a segregation of administrative nature and does not identify or record ownership.

6. Segregation of client position accounts

a. Omnibus client position account

The omnibus client position account is fully segregated from the house account, but the positions of the clients recorded in such account are commingled. This is the minimum level of segregation

required under EMIR.

This option is likely to be more economical both in terms of total margin called, settlement costs and number of collateral accounts required. The account will have a single margin call and will therefore benefit from margin netting across all clients within the account. It will also be possible to settle on a net basis across all clients if desired and facilitated by the Clearing Participant.

In the event of a Clearing Participant default (and a subsequent enforcement of the collateral), EuroCCP will close out the omnibus client positions at an aggregated level and not per underlying client. EuroCCP will not be able to attribute the enforced part of joint collateral holdings to any particular position, as collateral will cover the net result of the close out netting process. Any unused collateral remaining after the completion of the default management procedures shall be returned to the trustee(s) acting on behalf of those clients when known to EuroCCP or, if they are not, to the (insolvency practitioner of the) Clearing Participant for the account of its clients. (See in more detail the sections further below discussing the structure with a trustee).

b. Individual segregated client account

In the individual segregated client position account the client position is fully segregated from both the house account of the Clearing Participant as well as from any other client accounts. The main consequence of this option is that the segregated client position account will be margined and settled separately from other accounts. It will therefore not benefit from any cross client netting opportunities at margin or settlement level. A segregated individual position account will also require posting of sufficient collateral in (a) segregated collateral account(s).

In the event of Clearing Participant default (and a subsequent enforcement of the collateral) any unused collateral remaining after completion of the default management procedures will remain in this account.

7. Segregation of client collateral accounts

EuroCCP distinguishes three types of collateral accounts in its books:

1. Cash collateral accounts;
2. Accounts reflecting the securities transferred to EuroCCP as collateral;
3. Collateral accounts (for keeping both cash and securities) held with third parties, pledged to EuroCCP, which EuroCCP reflects in its books.

EuroCCP requires that a certain minimum percentage of collateral to cover margin requirements is held directly in one of the account types 1 and/or 2 above (currently this percentage is set at 70%). House position accounts, omnibus client position accounts and individual segregated client position accounts will be separately margined and the required collateral must be held in a linked collateral account. For a schematic overview, reference is made to the diagram attached hereto as Appendix A.

EuroCCP only requires the minimum percentage to be held at the overall Clearing Participant level. Consequently, a Clearing Participant could decide to hold all client collateral accounts with third parties (type 3). The Clearing Participant must then ensure that the overall collateral amount which must be placed with EuroCCP directly (i.e. the mandatory 70%), is held in a house collateral account of type 1 and/or 2. This reduces the number of additional accounts required and allows the Clearing Participant to manage its exposure to its clients. Should a Clearing Participant wish to meet the 70% requirement separately for the client account(s), it can request the opening of client collateral accounts (of the type 1 or 2) with EuroCCP to ensure that the 70% is held for each segregated client.

a. Collateral accounts in respect of omnibus client position accounts

The omnibus client position account also requires at least one omnibus client collateral account of the type 1 or 2 as set out above to be held with EuroCCP, if the Clearing Participant does not choose to meet the 70% requirement in full through the house collateral account. A collateral account type 3 can be held with a third party provided it is pledged to EuroCCP.

Balances owed and held in accounts of type 1 or 2 by EuroCCP after completion of default procedures (i.e. unused collateral) are to be readily returned to clients if known to EuroCCP. Because of potential friction between EMIR and applicable insolvency laws, EuroCCP will require (i) pre-arranged procedures with a trustee acting on behalf of the joint clients, (ii) a pledge agreement with the Clearing Participant as pledgor and the trustee as pledgee (on behalf of the clients) and (iii) a legal opinion confirming the validity and enforceability of these arrangements, in order to protect the interests of the clients and EuroCCP. In the absence of such arrangements, payment of residual collateral cannot be made to the clients directly without the express consent of the insolvency practitioner of the defaulting Clearing Participant.

In respect of account type 3, in the event of a Clearing Participant default (and a subsequent enforcement of the collateral under the pledge) any unused collateral remaining after completion of the default procedures will remain in this account with the third party and – without further arrangements being set up in advance between the Clearing Participant and its clients – are expected to be part of the bankrupt estate of the Clearing Participant.

Assets held in accounts of type 1 or 2 are provided to EuroCCP under a title transfer arrangement. This means that legal ownership has been transferred to EuroCCP. In the unlikely event of the insolvency of EuroCCP and provided the above discussed additional legal arrangements with a trustee have been established, these assets will not fall in the insolvency estate of EuroCCP.

Assets held in account type 3 are provided to EuroCCP under a security arrangement. Assets held in account type 3 are held on accounts in the name of the Clearing Participants with third parties. This means that legal ownership over these assets continues to reside with the Clearing Participant. In the event of the insolvency of EuroCCP these assets will therefore not fall in the insolvency estate of EuroCCP.

b. Collateral accounts in respect of individual segregated client position accounts

If individually segregated client collateral is held in the books of EuroCCP (i.e. accounts type 1 or 2), EMIR requires that collateral balances owed by EuroCCP after completion of default procedures, i.e. unused collateral, shall be readily returned to the client if known to EuroCCP. Because of potential friction between EMIR and applicable insolvency laws, EuroCCP will require a pledge agreement with the Clearing Participant as pledgor and the client as pledgee and a legal opinion confirming the validity and enforceability of the pledge, to protect the interest of the individual segregated client involved and EuroCCP. In the absence of such arrangements, payment of residual collateral will only be made with the express consent of the insolvency practitioner of the defaulting Clearing Participant.

It is not expected that collateral accounts of type 3 will be used in respect of individual segregated client position accounts. Should this be the case, the treatment in insolvency will be the same as in the case of type 3 collateral accounts in respect of omnibus client position accounts.

c. Conclusion

Assets held in account 1 or 2 may fall in the insolvency estate of EuroCCP if no trustee is appointed.

Assets held in account 3 will not fall in the insolvency estate of EuroCCP.

8. Clearing fund and interoperability fund

EuroCCP maintains a clearing fund account and an account for deposits in the EuroCCP interoperability fund for each (interoperable) Clearing Participant. The clearing fund serves as an additional financial buffer for EuroCCP should the collateral posted not be sufficient to cover for any losses due to the default of a Clearing Participant. When determining the size of the clearing fund, historic and future scenarios in respect of market conditions are taken into account. Per EMIR requirement, the clearing fund should be of a size that it is able to withstand, under extreme but plausible market conditions, the default of the two Clearing Participants to which it has the largest exposures.

Where a trade is entered into between two parties on a trade platform and each party chooses a different CCP to clear their trade then, provided that the respective CCPs have agreed to do so, a transaction arises between the two CCPs on the same terms to ensure that each party retains a balanced book. The two CCPs are therefore said to 'interoperate'. The CCPs run default risk on each other just like they would on any Clearing Participant. However, per EMIR requirement, CCPs do not contribute to each other's default funds but do pay collateral to each other on a daily basis. The interoperability fund is used to fund these additional collateral calls and the contributions of a Clearing Participant are calculated by EuroCCP by reference to the total amount of margin required compared to the exposure generated by that Clearing Participant. For more information please refer to the Regulation Interoperability Fund (<https://euroccp.com/document/regulation-interoperability-fund/?wpdmdl>).

Both the clearing fund as well as the interoperability fund are held at the level of the Clearing Participant and cannot be held segregated for clients. Contributions to both the clearing fund as well as to the interoperability fund can be in cash or securities acceptable for EuroCCP. The rules on segregation and portability do not apply to the assets held in the clearing fund and the interoperability fund.

9. Portability

As required under EMIR, the procedures for portability must be triggered at the request of the client(s). The portability procedures are limited to the client position accounts and cash collateral accounts in the books of EuroCCP and securities transferred to EuroCCP as collateral designated for covering client positions (collateral accounts of types 1 and 2 above). Transfer of collateral held with third parties (type 3 above) cannot be done by EuroCCP and must be arranged by the relevant Clearing Participants and clients separately.

The conditions for porting of positions and collateral held under omnibus client accounts and individual segregated client accounts include:

1. The request of the client concerned (or the trustee on behalf of all clients in an omnibus client account);
2. The existence of alternative clearing arrangements for the client(s) with a back-up Clearing Participant in accordance with the Clearing Rules²;
3. The unconditional acceptance by the back-up Clearing Participant of all positions;
4. A legal opinion on file on the on-going validity of the authority to port granted by the defaulting

² The alternative clearing arrangements are not necessarily required to be in place prior to the issuance of the Notice of Default, but of course need to be in place prior to any actual porting. However, if these arrangements are not in place ahead of the issuance of the Notice of Default, the likelihood of porting will be reduced.

Clearing Participant and the absence of anti-deprivation and/or avoidance rules, or the written consent of the insolvency practitioner appointed to administer the estate of the defaulting Clearing Participant;

5. Satisfactory certainty that all pending settlements with the defaulting Clearing Participant will be cancelled, and that new equivalent instructions with the back-up Clearing Participant will settle with good value.

To allow EuroCCP to continue to manage default situations in a prudent manner the time window for EuroCCP to ascertain whether these conditions are met, is a maximum of 4 hours. Please also refer to the Regulation Segregation and Portability (<https://euroccp.com/document/regulation-segregation-and-portability/?wpdmdl>).

In practice, due to the T + 2 settlement cycle in cash equity markets, there would be limited portability opportunities (especially in the case of omnibus accounts) as transactions are either allowed to settle or are closed out.

10. Treatment of client accounts in insolvency

EuroCCP is a limited liability company (*naamloze vennootschap*) incorporated under the laws of The Netherlands. Questions related to an insolvency of EuroCCP will be determined by Dutch law.

In the event of insolvency of EuroCCP, the assets held as margin with third party agents and pledged to EuroCCP will not form part of EuroCCP's estate. The assets held directly with EuroCCP (for instance, the clearing fund contributions and a minimum of 70% of the collateral to cover the margin requirements) will form part of EuroCCP's estate. There is no separate insolvency or resolution regime for CCPs under Dutch law³. Under the Dutch Bankruptcy Act, the insolvency practitioner will liquidate EuroCCP's assets. The proceeds of the liquidation will be distributed among EuroCCP's creditors. The Clearing Participants will rank *pari passu* with other general creditors.

Questions related to an insolvency of a Clearing Participant will in general be determined by the insolvency laws of the jurisdiction of incorporation of the Clearing Participant. In addition, the applicable laws on property aspects (such as the law of the location of the assets or the law governing the security rights on the assets) and the laws which govern the relationship between the Clearing Participant and its clients may also be of relevance in determining the rights of the clients vis-à-vis the Clearing Participant in case of its insolvency.

Clients of Clearing Participants should consider whether and how the contractual arrangements between them and their Clearing Participant and their property rights could be affected in case of insolvency of the Clearing Participant. In this relation, it is important that clients review the information disclosed by their Clearing Participant under EMIR.

11. Costs

As discussed above, a major consequence of individual segregation will be the reduction of netting opportunities for the Clearing Participant at both margin and settlement level. EuroCCP will provide the minimum level of segregation required (separate house accounts, client position accounts and collateral accounts) as part of its standard membership service. However, if Clearing Participants wish individual client segregation, this is part of the offering of EuroCCP against a charge of EUR 500 per calendar month to cover the additional administration and monitoring required. The fee will be charged per segregated client and not per collateral account used. Please also refer to the Regulation

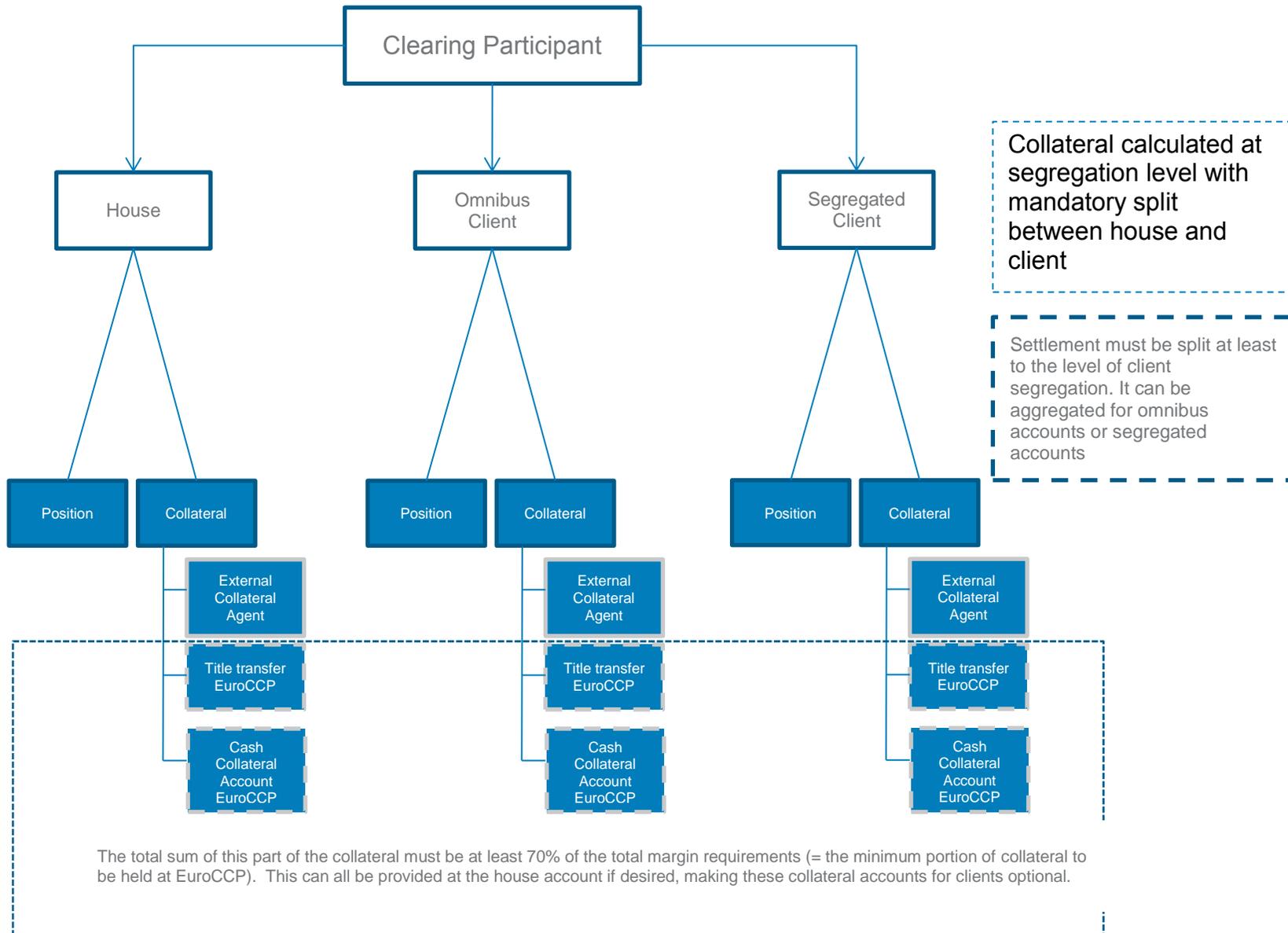
³ At the date of this document the EU Regulation on CCP Recovery and Resolution is in the making.

Fees and Penalties (<https://euroccp.com/document/regulation-fees-penalties/?wpdmdl>).

12. Risk Disclosure Statement

Please also refer to the EuroCCP Disclosure Statement which is a risk disclosure statement for the purposes of article 38(2) EMIR and is available on the website (<https://euroccp.com/document/euroccp-disclosure-statement/?wpdmdl>). It contains information of the risks associated with using the services of EuroCCP.

Appendix A: Overview account offering



IMPORTANT NOTICE

This document does not constitute legal or any other form of advice and must not be relied on as such. This document provides a high level analysis of complex matters. It does not provide all the information you may need to make your decision on which account type or level of segregation is suitable for you. It is your responsibility to review and conduct your own due diligence and assessment on the relevant rules, legal documentation and any other information provided to you on each of EuroCCP's client account offerings and, where applicable, those of the various Clearing Participants. You may wish to appoint your own professional advisors to assist you in this assessment.

EuroCCP shall under no circumstances be liable, whether in contract, tort, breach of statutory duty or otherwise, for any loss or damages (whether direct, indirect or consequential loss or loss of profit or revenue, damage to reputation or loss of any contract or other business opportunity or goodwill) that may be suffered as a result of this document or the information contained herein, except for liability which cannot be excluded by law.