

EuroCCP's disclosure under article 39 (7) of EMIR and disclosure under article 38 (6) of CSDR related to account segregation and portability offering,

Issuing department: Legal and Compliance

Reviewed: 23 November 2020

Next review: 23 November 2021

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. This document further contains a disclosure under article 38 (6) of CSDR².

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/home/participants-centre/documentation/#regulations>).

1. 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’*)”.

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>

² Regulation (EU) No 909/2014 of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014R0909>

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 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.”*

2. 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.

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

Each of the above account types will consist of a position account and a collateral account. Clearing Participants that only clear their own proprietary positions will only have a house account. Clearing Participants that also clear on behalf of their clients will also have omnibus client accounts and/or individual segregated client accounts.

Under EMIR, each type of account must be maintained separately from any other type of account. This means that the client positions and collateral belong to one type of account cannot be used to offset or margin another type of account.

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

4. Segregation of client position accounts

a. Omnibus client account

The omnibus client account of a Clearing Participant is fully segregated from the house account, and from any individually segregated client 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 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 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 collateral held against these positions to any particular client within the omnibus account, as collateral held 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 known, 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 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, and collateral received in respect of margin obligations will be recorded separately from collateral provided for any other account. It will therefore not benefit from any cross client netting opportunities at margin or settlement level.

5. Collateral accounts

The collateral accounts which can be associated with each of the three types of accounts listed above in Section 4 are:

- a) Cash collateral accounts;
- b) Accounts reflecting the securities transferred to EuroCCP as collateral;
- c) 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 100% of required margin is held directly with EuroCCP in either account type a) & b). House, omnibus client and individual segregated client accounts will be separately margined for the positions held in the specific account and the required collateral must be held in a linked collateral account. Only in limited cases collateral can be held in accounts of type c). For a schematic overview, reference is made to the diagram attached hereto as Appendix A.

a. Collateral accounts in respect of omnibus client accounts

The omnibus client account requires at least one omnibus client collateral account of the type a) or b) as set out above to be held with EuroCCP. A collateral account type c) can be held with a third party provided it is pledged to EuroCCP but only in limited circumstances.

Balances owed and held in accounts of type a) or b) 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 requires (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 c), in the event of a Clearing Participant default (and a subsequent enforcement 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 a) or b) 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 c) are provided to EuroCCP under a security arrangement. Assets held in account type c) are held in accounts in the name of the Clearing Participant 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 accounts

If individually segregated client collateral is recorded on the books of EuroCCP (i.e. accounts type a) or b)), 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 c) 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 c) collateral accounts in respect of omnibus client accounts.

c. Conclusion

Assets held in account a) or b) may become part of the insolvency estate of EuroCCP if no trustee is appointed. Assets held in account c) do not become part of the insolvency estate of EuroCCP.

6. 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 margin collateral posted not be sufficient to cover 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 with 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 (clearing fund) but do pay collateral to each other on a daily basis. The interoperability fund is used to resource the interoperating CCP 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.

Both the clearing fund as well as the interoperability fund are held at the level of the Clearing Participant and cannot be held segregated at client level. 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.

7. 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 accounts and linked cash collateral accounts recorded to the books of EuroCCP and securities transferred to EuroCCP as collateral designated for covering client positions (collateral accounts of types a) and b) above). Transfer of collateral held with third parties (type c) above) cannot be facilitated 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 Rules³;
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 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.

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.

8. Treatment of client accounts in insolvency

EuroCCP is a limited liability company (*naamloze vennootschap*) incorporated under the laws of The Netherlands. Questions related to the 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 will form part of EuroCCP's estate. There is no separate insolvency or resolution

³ 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.

regime for CCPs under Dutch law⁴. 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.

9. Costs

As discussed above, a major consequence of the individual segregated client accounts will be the reduction of netting opportunities at both margin and settlement level. EuroCCP will provide the minimum level of segregation required (separate house accounts, and omnibus client accounts) as part of its standard membership service. However, if Clearing Participants wish individual segregated client accounts, a charge of EUR 500 per calendar month will be applied to cover the additional administration and monitoring required. Please also refer to the Regulation Fees and Penalties on our website.

10. 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 our website. It contains information of the risks associated with using the services of EuroCCP.

Disclosure under article 38 (5) and (6) of CSDR

11. Central Securities Depository Regulation (CSDR)

Article 38 (5) CSDR states:

“A participant shall offer its clients at least the choice between omnibus client segregation and individual client segregation and inform them of the costs and risks associated with each option.”

Article 38 (6) CSDR states:

“CSDs and their participants shall publicly disclose the levels of protection and the costs associated with the different levels of segregation that they provide and shall offer those

⁴ At the date of this document the EU Regulation on CCP Recovery and Resolution is in the making.

services on reasonable commercial terms. Details of the different levels of segregation shall include a description of the main legal implications of the respective levels of segregation offered, including information on the insolvency law applicable in the relevant jurisdictions.”

The CSDR was written with the aim of improving the settlement of securities within the EU, to create common rules for European central securities depositories (CSDs). EuroCCP is a participant of many CSDs in the EU and hence the above two requirements could be seen as applicable to EuroCCP.

Due to its specific nature as a CCP and its principal to principal relationship with clearing participants, EuroCCP only operates in these CSDs for own account. EuroCCP does not act as a custodian for any of its clearing participants. However, for collateral administration purposes any collateral provided by clearing participants under title transfer can upon request also be registered in an omnibus client collateral account or an individual segregated collateral account at the level of the CSD.

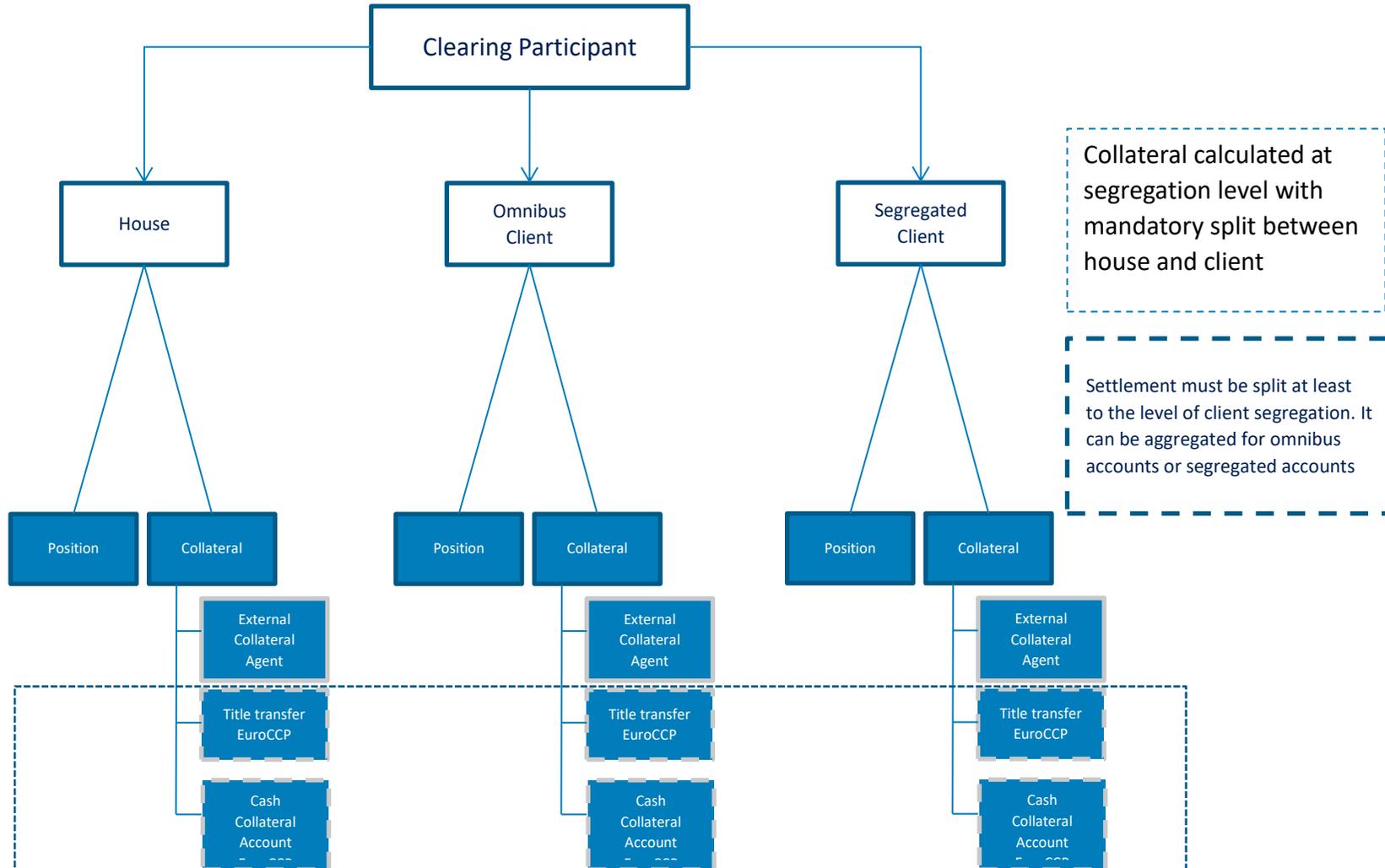
As discussed above, due to the principal to principal relationship between EuroCCP and each clearing participant, the designation of collateral accounts in the books of the CSD as segregated omnibus client accounts or individual segregated client accounts is a segregation of administrative nature and does not identify or record ownership, or result in additional safeguards for the clearing participants in the unlikely event of the insolvency of EuroCCP. As indicated above in the disclosure for the purposes of EMIR article 38(7), questions related to the 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 will form part of EuroCCP's estate. There is no separate insolvency or resolution regime for CCPs under Dutch law. The assets held directly with EuroCCP will form part of EuroCCP's estate in the event of its insolvency. The risks of these account segregation options are no different from what is discussed under sections 1-11 of the disclosure for the purposes of EMIR article 38(7).

If clearing participants wish segregated omnibus client collateral accounts or individual segregated client collateral accounts at the CSD level, EuroCCP will charge EUR 500 per calendar month per account to cover the additional administration and monitoring required. Please also refer to the Regulation Fees and Penalties on our website. The relevant CSD may also apply additional charges which EuroCCP will pass on to the clearing participant. All charges are subject to change.

Reference is made to the disclosures under article 38 (5) and (6) of CSDR of each relevant CSD.

Appendix A: Overview EMIR 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.