

# MFSA

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## MALTA FINANCIAL SERVICES AUTHORITY

### **Circular to the financial services industry on Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties (CCPs) and trade repositories (TRs) ('EMIR')**

This circular follows the circular issued by the Malta Financial Services Authority ('MFSA') on the 31<sup>st</sup> October 2012, whereby the Authority *inter alia* explained that it is currently working on the implementation of EMIR.

The MFSA has during the past weeks worked on the establishment of a legal framework for the implementation of EMIR. In this regard, please refer to the following, which have been attached to this circular:

1. Draft Legal Notice entitled Financial Markets Act (OTC Derivatives, Central Counterparties and Trade Repositories) Regulations, 2012; (**Refer to Annex I**) and
2. Draft Guidance Notes to Central Counterparties Regulation. (**Refer to Annex II**)

The legal notice and the guidance notes are in the process of being adopted. In the meantime, a separate set of Guidance notes on OTC Derivatives and Trade Repositories is being drafted and will be issued in due course.

### **Contacts**

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**Communications Unit**  
**Malta Financial Services Authority**  
**29<sup>th</sup> November, 2012**

## Annex I

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*Chairman*  
Malta Financial Services Authority

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Minister of Finance, the Economy and  
Investment

L.N. of 2012

### FINANCIAL MARKETS ACT

(CAP. 345)

#### Financial Markets Act (OTC Derivatives, Central Counterparties and Trade Repositories) Regulations, 2012

IN exercise of the powers conferred by article 49 of the Financial Markets Act, the Minister of Finance, the Economy and Investment, acting on the advice of the Malta Financial Services Authority, has made the following regulations:

Title,  
commencement  
and scope.

**1.** (1) The title of these regulations is the Financial Markets Act (OTC Derivatives, Central Counterparties and Trade Repositories) Regulations, 2012.

Definitions.

Cap. 345.

(2) The purpose of these regulations is to create a registration framework for OTC Derivatives, central counterparties and trade repositories and, in part, to implement the relevant provisions of the EMIR Regulation on OTC derivatives, central counterparties and trade repositories as herein defined, and they shall be interpreted and applied accordingly.

(3) Regulations 3 to 9 of these regulations shall enter into force on such date as the Minister may prescribe by order in the Government Gazette.

2. (1) In these regulations, unless the context otherwise requires:

“the Act” means the Financial Markets Act;

“central counterparty” means a legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer;

“EMIR Regulation” means Regulation (EU) No 648/2012 of the European Parliament and of the Council of the 4th July, 2012 on OTC derivatives, central counterparties and trade repositories as amended from time to time;

Cap. 330.

“Financial Services Tribunal” means the Tribunal established in terms of article 21 of the Malta Financial Services Authority Act;

“OTC derivative” means a derivative contract the execution of which does not take place on a regulated market or on a third country market considered as equivalent to a regulated market in accordance with article 19(6) of Directive 2004/39/EC on markets in financial instruments as amended;

“proposed acquirer” means any natural or legal person or persons acting in concert, who have taken a decision either to acquire, directly or indirectly, a qualifying holding in a central counterparty or to further increase, directly or indirectly, such a qualifying holding in a central counterparty as a result of which the proportion of the voting rights or of the capital held would reach or exceed 10%, 20%, 30% or 50% or so that the central

counterparty would become its subsidiary.

“trade repository” means a legal person that centrally collects and maintains the records of derivatives.

(2) Words and expressions used in the Act shall, in these regulations, have the same meaning as is assigned to them in the Act

Competent authority

**3.** The Malta Financial Services Authority established by the Malta Financial Services Authority Act shall be the designated competent authority in Malta for the purposes of implementing the relevant provisions of the EMIR Regulation, and any reference in these regulations to the competent authority shall be read and construed accordingly.

Applicability of the EU Regulation to the competent authority

**4. (1)** The competent authority shall exercise all the functions, obligations and powers and shall satisfy all the requirements imposed on competent authorities by the EMIR Regulation.

(2) Without prejudice to sub-regulation (1), the competent authority may, for the better implementation of the EMIR Regulation, exercise any of the powers assigned to it under the Act in relation to persons acting as central counterparties or trade repositories and, or who are responsible for clearing and bilateral risk-management requirements for OTC derivatives and, or who are responsible for reporting requirements for derivative contracts.

Registration of central counterparties.

**5. (1)** No person shall operate a central counterparty in or from Malta, or shall provide, or hold itself out to be or provide the services of a central counterparty in Malta unless such person has been granted a registration for this purpose issued by the competent authority in terms of this regulation.

(2) An application for registration to operate a central counterparty in terms of sub-regulation (1) shall be made to the competent authority in writing and shall be accompanied by such documents as the competent authority may specify.

(3) The competent authority shall not grant registration to operate a central counterparty in terms of sub-regulation (1) unless it is satisfied that the applicant or applicants are fit and proper persons and are in a position to comply with any conditions which the competent authority may deem fit to impose.

Withdrawal of registration.

**6.** The competent authority shall not register, and it shall withdraw a registration issued under regulation 5, as the case may be, where:

(a) the holder thereof is not fit and proper to act as a central counterparty;

(b) the holder thereof does not fulfill the requirements of registration, or has contravened any of the conditions of registration;

(d) the holder thereof, or a person acting on its behalf, has furnished the competent authority with information which is false, inaccurate or misleading;

(e) registration has been obtained through false statements or by other irregular means; or

(f) at the request of the holder thereof.

Registration does not authorise activities requiring approval or authorization in terms of the Central Bank of Malta Act or any other law.

**7.** Nothing in these regulations shall be construed as enabling or empowering a central counterparty to perform a function or activity which requires and approval or authorisation in terms of the Central Bank of Malta Act.

**8.** For the better carrying out of the provisions of the EMIR Regulation and of these regulations, the competent authority may, from time to time, issue and publish Financial Market Rules which shall be binding on all persons acting as central counterparties or trade repositories and, or who are responsible for clearing and bilateral risk-management requirements for OTC derivatives and, or who are responsible for reporting requirements for derivative contracts. Such rules may lay down additional requirements and conditions in relation to these matters as the competent authority may consider appropriate including:

(a) the operation of the EMIR Regulation or of these regulations;

(b) any matter relating to the functions, obligations and powers of the competent authority under the EMIR Regulation; and

(c) any other matter arising in connection with the EMIR Regulation or these regulations.

**9.** The provisions of the EMIR Regulation shall apply to persons acting as central counterparties or trade repositories and, or who are responsible for clearing and bilateral risk-management requirements for OTC derivatives and, or who are responsible for reporting requirements for derivative contracts in or from Malta and such persons shall exercise all the obligations and satisfy all the requirements imposed on such persons by the said EMIR Regulation.

Publication of reasons for refusal.

**10.** For the purposes of article 31(5) of the EMIR Regulation, the competent authority may, whether or not at the request of the proposed acquirer in a central counterparty, issue a public statement indicating the reasons as to why it has refused the proposed acquisition of the central counter party requested by the proposed acquirer.

Administrative penalties.

**11.** Where a person acting as a central counterparty or trade repository and, or who is responsible for clearing and bilateral risk-management requirements for OTC derivatives and, or who is responsible for reporting requirements for derivative contracts contravenes or fails to comply with any provisions of the EMIR Regulation, these regulations and any Financial Markets Rules issued thereunder, the competent authority may, by notice in writing and without recourse to a court hearing, impose on such person an administrative penalty not exceeding one hundred and fifty thousand (€150,000) euro.

Appeals.

**12.** A right of appeal to the Financial Services Tribunal shall lie from a decision of the competent authority to impose a penalty under regulation 11.

EMIR Regulations to prevail in case of any inconsistency.

**13.** Upon the coming into force of Title III of the EMIR Regulation, these regulations shall be construed and applied in accordance therewith and, insofar as the provisions of these regulations are inconsistent with the provisions of the said EMIR Regulation, the provisions of the EMIR Regulation shall prevail and the provisions of these regulations shall not apply to the extent of the inconsistency.

MFSA

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MALTA FINANCIAL SERVICES AUTHORITY

**DRAFT  
GUIDANCE NOTES**

**to**

**Central Counterparties  
Regulation**

**November 2012**



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## SECTION A - INTRODUCTION

**Central Counterparties ('CCPs')** are fundamentally entities that interpose themselves between the two counterparties to a transaction and thus become the 'buyer to every seller', as well as the 'seller to every buyer'. A CCP's main purpose is to manage the risk that could arise if one counterparty is not able to make the required payments when they are due

Back in 2009, at the peak of the financial crisis, G20 leaders agreed that, in order to reduce counterparty's and operational risks related to over-the-counter ('OTC') derivatives trading, by the end of 2012 all standardised OTC contracts would be traded on exchanges or electronic trading platforms and, where appropriate, cleared through central counterparties ('CCPs').

In the EU, the European Market Infrastructure Regulation ('EMIR') was adopted by the European Parliament on the 29<sup>th</sup> March 2012 with the European Parliament approving the text agreed with the Commission. EMIR came into force twenty days after its publication in the Official Journal of the European Union, i.e. following the 4<sup>th</sup> July 2012.

Titles III-V of EMIR lay down the conditions and procedures for the authorisation and supervision of a CCP. Since CCPs are to take on additional risks, they will be subject to stringent business conduct and harmonised organisational and prudential requirements to ensure their safety. Moreover, EMIR has provisions which requires the European Banking Authority ('EBA') and European Securities and Markets Authority ('ESMA') to develop a number of draft regulatory technical standards.

### I. THE EU REGULATION, REGULATORY AND IMPLEMENTING TECHNICAL STANDARDS

Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade

repositories ('EMIR') entered into force on 16 August 2012.

Many of the provisions in EMIR require technical standards to be developed by ESMA and the EBA, delivered to the European Commission of the 27 September 2012. The actual date of application of these provisions will depend on the date of entry into force of these technical standards.

From the entry into force, the different obligations will start applying in accordance with the deadlines set forth in EMIR and relevant technical standards. The entry into force is also relevant for determining: the deadline for CCPs established in the EU/EEA to submit their application for authorisation under EMIR (6 months after entry into force). The NCAs then have 6 months to determine whether or not to authorise the CCP after having received a complete application; and the deadline for third country CCPs to submit their application for recognition under EMIR (6 months after entry into force). ESMA then has 6 months to determine whether or not to recognise the CCP after having received a complete application.

The following are the relevant technical standards applicable to CCPs.

- (Draft Regulatory technical standards on CCP requirements) Commission Delegated Regulation (EU) No xxx of [ date] supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 with regard to **regulatory technical standards on requirements for central counterparties**.
- Draft implementing technical standards on record keeping requirements for CCPs Commission Implementing Regulation (EU) No xxx of [ date] laying down **implementing technical standards with regard to the format of the records to be maintained by central counterparties**
- (Draft Regulatory technical standards on trade repositories) Commission Delegated Regulation (EU) No xxx of [ date] supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 with regard to **regulatory technical standards on the minimum details of the data to be reported to trade repositories**
- EBA Final draft **Regulatory Technical Standards on Capital Requirements for Central Counterparties** under Regulation (EU) No 648/2012

The above legislation can be downloaded from the section of the MFSA web-page: [<http://www.mfsa.com.mt/pages/>]

In Malta, the provisions of EMIR will be implemented through the adoption of the Financial Markets Act (OTC Derivatives, Central Counterparties and Trade Repositories) Regulations, 2012 [L.N. xxx of 2012]. This Legal Notice appoints the Malta Financial Services Authority ('MFSA') as competent authority for the purposes of the Regulation, thus meaning that the MFSA is responsible for carrying out the duties resulting from the EU Regulation for the authorisation and supervision of CCPs established in its territory.

Moreover, the Central Bank of Malta Act charges the Central Bank of Malta to ensure the stability of the financial system. In fulfilling this statutory obligation, the Central Bank of Malta plays a key role in maintaining the stability of the domestic financial system, whilst further contributing to that of the Euro system. The Central Bank of Malta defines financial stability as a condition where the financial system – comprising institutions, markets and infrastructures – is able to allocate savings into investments opportunities and facilitate the settlement of payments efficiently; manage risks that may harm or threaten to harm its performance and consequently that of the economy; and absorb shocks without allowing the formation of cumulative processes that may impair its operations.

The Central Bank of Malta (the Bank) is responsible for the regulation and oversight of domestic securities settlement systems. MaltaClear and TBClear are the securities settlement systems currently authorised by the Bank.

A Memorandum of Understanding, signed on 5 January 2011 between the Central Bank of Malta and the Malta Financial Services Authority extends the agreement to establish procedures to provide for the mutual exchange of information to ensure financial stability within the financial system in Malta and to cover the regulation, oversight, and the smooth running of payment and securities settlement systems in Malta.

## II. PURPOSE OF THESE GUIDANCE NOTES

Whilst the the main obligations under EMIR are:

1. Clearing obligation for certain classes of OTC derivatives;
2. Risk mitigation techniques for non-centrally cleared OTC derivatives;
3. Organisational, conduct of business and prudential requirements for CCPs;
4. Reporting obligation to trade repositories; and
5. Trade repositories requirements, including the duty to make certain data available to the public and relevant authorities.

These Guidance notes will be focusing on point 3 and aspects of point 4. Points 1, 2 and 5, that is issues relating to OTC derivative and Trade Repositories will be dealt with in a separate set of Guidance notes.

The Malta Financial Services Authority (henceforth referred to as the 'MFSA') as competent authority for the purposes of the **Financial Markets Act, 1990**, has the function of administering the said **EU Regulation**.

The purpose of these Guidance Notes is to afford potential CCP applicants with a general view of the requirements with respect to the authorisation and on-going compliance of a CCP set out in the EU Regulation. The main areas contained in these guidance notes refer to the:

- 1. Authorisation of a CCP in Malta;**
- 2. Organisational requirements;**
- 3. Conduct of business;**
- 4. Prudential requirements;**
- 5. Interoperability;**
- 6. Administrative sanctions; and**
- 7. Contacts**

### III. DISCLAIMER

As indicated above, these Guidance Notes are aimed at assisting CCPs interpret and understand better the applicable regulatory requirements and do not in any manner replace the Regulation, the Commission Regulations, the ESMA Technical standards and Guidance or the Financial Markets Act (OTC derivatives, central counterparties and trade repositories) Regulations, 2012 [L.N. xxx of 2012], which CCPs are bound to comply with.

**Persons falling within the scope of regulatory framework are encouraged to obtain a proper understanding of the legislation and the relevant ESMA Technical standards and Guidance.**



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## SECTION B – AUTHORISATION CONDITIONS

### 1.0 AUTHORISATION OF A CCP IN MALTA

#### **1.1 Transitional provision for the registration of a CCP**

The MFSA has, by way of Legal Notice [xxx of 2012] adopted, as from the date of the publishing of the Legal Notice in the government gazette, [still in draft] transitional provisions for the registration of a CCP in Malta prior to the full entry into force of EMIR and its technical and implementing standards. Under this provisional regime the MFSA will be solely responsible for the registration of a CCP in Malta.

Before the date of applicability of Chapter 1 of Title III of EMIR, no person shall operate a securities central counterparty or shall provide, or hold itself out to be or provide, the service of a securities central counterparty in or from Malta unless such person is in possession of a written registration issued by the MFSA under Legal Notice [xxx]. A securities central counterparty is as a legal person which offers clearing services and that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer. The regulation and oversight of payment and settlement systems remain the responsibility of the Central Bank of Malta.

Anybody legal or natural person may apply in writing to the MFSA for a registration under the above Legal Notice, to act as a central counterparty.

Registration to act as a central counterparty may be granted only where the MFSA is satisfied that the applicant is a fit and proper person and complies and/or will be in a position to comply with the conditions which the competent authority may deem fit for this purpose.

A registration may be revoked by an order issued in writing by the competent authority at the request of the central counterparty or if it appears to the competent authority that the central counterparty has failed to satisfy the conditions for registration.

Below is a non-exhaustive list of application documents which are expected to be submitted to the MFSA. The MFSA may require the applicant to submit additional documents to support the application prior to making a final decision on the application.

##### *1.1.1 Request for registering as a CCP*

An official letter requesting the MFSA for a registration to act as a CCP in Malta under legal notice [xxx] together with documentation which will enable the MFSA to ensure that the applicant is a fit and proper person and that it complies and will be in a position to comply with the conditions which the competent authority may deem fit for this

purpose.

### *1.1.2 Financial resources*

The CCP must satisfy the MFSA that it has sufficient financial resources for the proper performance of its functions. The applicant may be requested to complete financial returns which calculate the appropriate level of capital on the basis of the applicant's expected risk;

### *1.1.3 Constitution, governance, organisational structure and management systems of the CCP*

Details in relation to the :

- organisation structure and management systems of the applicant, including details on the shareholding structure and of any committees to be established as well as their respective terms of reference;
- the decision making procedures with clearly defined reporting lines;
- the internal control mechanisms;
- personal questionnaire of members of the board and senior management in the format presented under the Act;
- a detailed business plan specifying the applicant's operations, including the types of business envisaged, together with a three year forecasted balance sheet, income statement, statement of changes in equity and cash flow statement;
- the risk management policies and procedures - The registered person shall have in place an effective risk management process with a view to manage its risks;
- the conflicts of interest policies;
- detailed systems and controls used in the performance of its functions;
- business continuity plans;
- compliance and money laundering function;
- complaints handling procedures;
- record keeping - A registered person shall maintain proper accounting records to show and explain the Authorised Person's own transactions, assets and liabilities. These requirements should be aligned to the record keeping

requirements detailed in the EMIR draft implementing technical standard on record requirements for CCPs.

#### *1.1.4 Clearing regulations*

The applicant's regulations for clearing members, specifying the membership, eligibility and suitability criteria, conduct of business, fees, fines and other charges and any other regulation applicable to clearing members.

#### *1.1.5 Prudential requirements*

- Capital requirements – The applicant is required to ensure adequate levels of capital when considering the level of risks associated with the applicant's activities. The MFSA would expect a CCP registered under these transitional provisions, to comply with financial resources standards which are equivalent with the standards required under the Capital Requirements Directive. The applicant may be requested to complete financial returns which calculate the appropriate level of capital on the basis of the applicant's expected risk;
- Margin requirements - Details of the margin requirements on clearing members;
- Default rules/Default Fund details to limit the applicant's exposure to its clearing members;
- Collateral requirements policy. The applicant should accept highly liquid collateral with minimal credit and market risk to cover its initial and on-going exposure to its clearing members.

#### *1.1.6 Outsourcing agreements*

Copies of any outsourcing agreements entered into in carrying out the CCP functions.

#### *1.1.7 Cooperation with the competent authority*

The CCP shall cooperate at all times and on an on-going basis, by sharing of information or in any other matter, with the competent authority.

## **1.2 Authorisation regime under EMIR - Role of ESMA in supporting the MFSA in regulating CCPs**

The EU Regulation gives the European Securities and Markets Regulator ('ESMA') a key role in the authorisation and supervision of CCPs. ESMA will be a member of the **Colleges** supporting national authorities, including the MFSA, in supervising CCPs operating in several member states.

EMIR establishes that during the authorisation process of a CCP, there would be strong cooperation between all of the public authorities concerned (supervisory authorities, central banks, etc) from all of the Member States involved.

In the event that the public authorities have legitimate concerns about the authorisation of a CCP, the EMIR includes a mechanism that allows those authorities to raise their concerns and, if necessary, to request ESMA to take a final decision using a procedure of binding mediation.

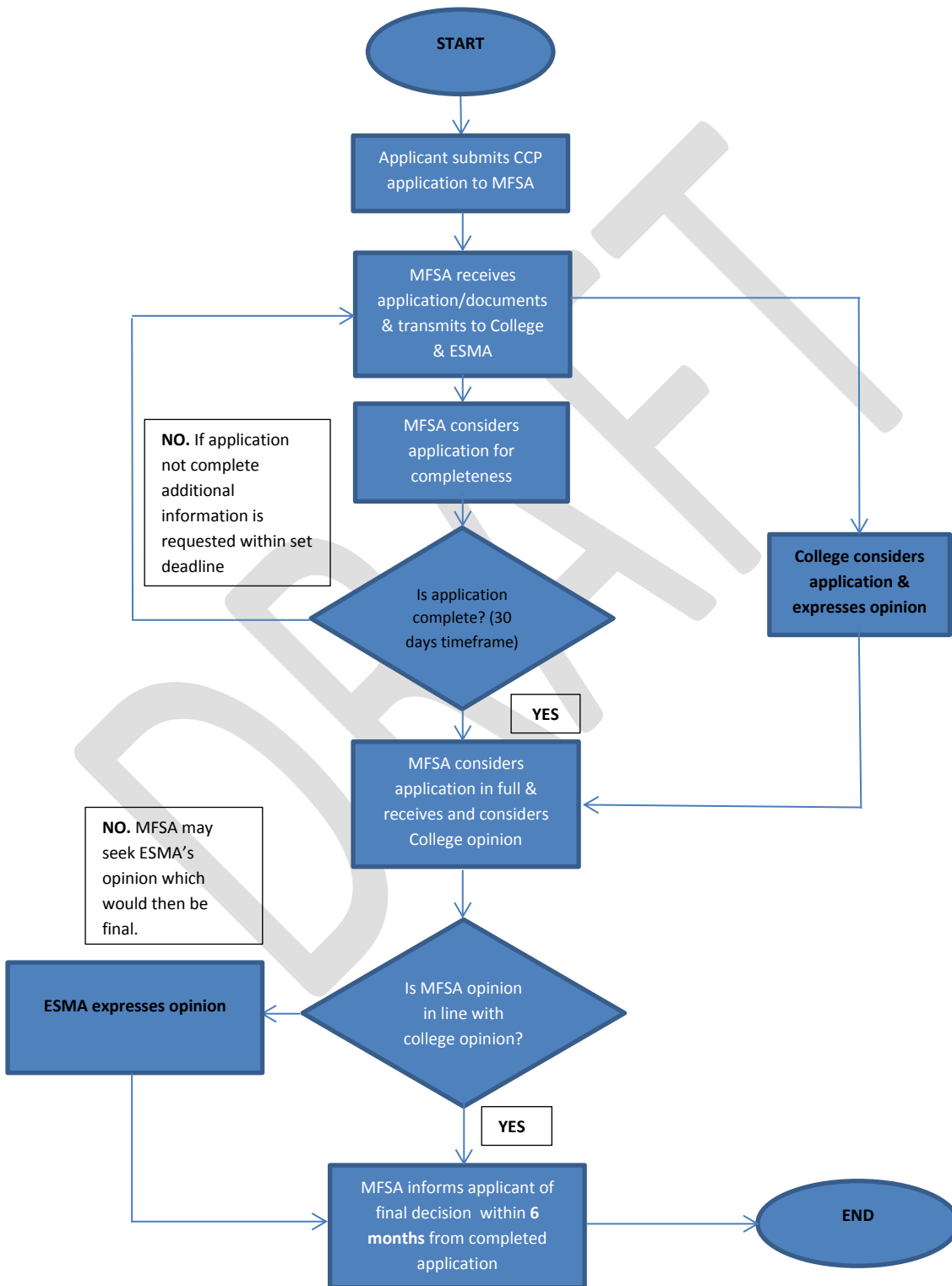
The mechanism to request binding mediation by ESMA is balanced and takes into account the interests and concerns of both the home authorities (authorities of the Member States in which the CCP is established) and the host authorities (authorities of the Member States in which the CCP provides its services).

Host authorities cannot request binding mediation by ESMA against the opinion of a home country authority unless the host authorities agree to do so unanimously, or if a significant number (two-thirds) of the host authorities are concerned with the proposed authorisation and agree to request binding mediation.

ESMA may recognise a CCP established in a third country if certain conditions are met. The main condition for this recognition is whether the CCP is authorised in the relevant third country and is subject to effective supervision and enforcement ensuring a full compliance with the prudential requirements applicable in that third country. The other criteria are more general with respect to the jurisdiction: **[i]** it has passed a Commission equivalence assessment and **[ii]** the relevant third country competent authority has agreed adequate supervisory co-operation arrangements with ESMA.

The following diagram provides a brief overview of the authorisation process.

**Diagram 1 Simplified authorisation process**



## SECTION C – ON-GOING OBLIGATIONS

### 2.0 ORGANISATIONAL REQUIREMENTS FOR CCPS

The CCP is required to have governance arrangements designed in such a way as to promote sound and prudent management, thereby supporting financial stability and fostering fair and efficient markets. These arrangements need to ensure that the board of a CCP assumes final responsibility and accountability for managing the CCP's risks.

The organisational structure needs to be well defined together with the policies, procedures and processes by which its board and senior management operate. These arrangements shall be clearly specified and well-documented.

#### *2.1 Senior Management and the board*

The CCP is required to maintain its own human resources for all of its functions. This enables the CCP and the MFSA to fully rely on the dedicated resources, to assess the time dedicated to the CCP activity and to prevent possible conflicts of interest.

The composition and minimum roles and responsibilities of the board and the senior management are listed in the delegated regulation for CCPs.

The CCP may outsource certain functions (under the EMIR requirements for outsourcing), however under an outsourcing arrangement the CCP will need to retain full control over the outsourced function and would need to manage conflicts of interest.

Moreover, CCPs need to have in place a remuneration policy which promotes the soundness and effectiveness of its risk management, by preventing the entity to engage in incentives to excessive risk-taking and

to prevent a relaxation of risk standards that may arise from inappropriate remuneration.

## *2.2 Record Keeping*

Record keeping is an essential element for the MFSA to assess the CCP's compliance with the relevant regulations and a useful tool to monitor clearing members and, where relevant, clients activities and behaviours.

The record keeping requirements detailed in the EMIR draft implementing technical standard on record requirements for CCPs, provides templates for retaining certain records in relation to:

- each contract processed;
- each position;
- activities related to the CCP business and internal organisation;

Moreover, a CCP is required to provide the MFSA with the records and information referred to above in a format that allows a direct data feed between the CCP and the MFSA. The CCP shall therefore establish such data feed within 6 months after the MFSA request.

## *2.3 Reporting to a trade repository*

CCPs need to ensure that the details of any derivative contract they have concluded and of any modification or termination of the contract are reported to a trade repository. The details need to be reported no later than the working day following the conclusion, modification or termination of the contract.

The technical standards further define the format and frequency of the reports required to be sent to the trade repository, and the date by which derivative contracts are to be reported, including any phase-in for contracts entered into before the reporting obligation applies.

## *2.4 Information to the MFSA*

A CCP is required to notify the MFSA of any changes to its management, and is required to provide all relevant information. Moreover, certain changes in the shareholding structure of the CCP should be notified to the MFSA prior to being effected.

### *2.5 Conflicts of interest*

There must be in place written organisation or administrative arrangements to identify and manage any potential conflicts of interest between itself, its managers, employees, or any person with direct or indirect control or close links, and its clearing members or their clients known to the CCP.

### *2.6 Business continuity*

The CCP must have in place an adequate business continuity policy and disaster recovery plan aiming at ensuring the preservation of its functions, the timely recovery of operations and the fulfilment of the CCP obligations. As a minimum, the plan should allow for the recovery of all transactions at the time of disruption to allow the CCP to continue to operate with certainty and to complete settlement on the scheduled date.

The ESMA technical standards indicate the minimum content and requirements of the business continuity policy and disaster recovery plan and the requirements that should be specified.

### *2.7 Risk Management*

CCPs are required to have a strong framework for the comprehensive management of all material risks to which it is or may be exposed. The framework should consist of documented policies, procedures and systems that identify, measure, monitor and manage such risks. The CCP shall also provide incentives to its clearing members to manage and contain the risks they pose to the CCP.



CCPs are also required to establish a risk management committee, which has the necessary authority, resources, expertise and access to all relevant information, is sufficiently independent from management and has a direct reporting line to the board.

Moreover, the CCP is required to have in place an independent, permanent and effective compliance function. This function, which should be under the responsibility of a chief compliance officer, should have the necessary authority, resources, expertise and access to all relevant information; and should take into account the nature scale and complexity of its business and the nature and range of the services and activities undertaken in the course of that business.

The IT systems employed by the CCP should be reliable and secure, and capable of processing the information necessary for the CCP to perform its activities and operations in a safe and efficient manner.

### *2.8 Liquidity risk controls*

CCPs are required to establish a robust liquidity risk management framework which shall include effective operational and analytical tools to, identify, measure and monitor its settlement and funding flows on an ongoing and timely basis, including its use of intraday liquidity. CCPs shall regularly assess the design and operation of their liquidity management framework, which should ensure that the CCP is able to affect same-day and, where appropriate, intraday settlement of payment obligations in all relevant currencies. It shall also include the assessment of its potential future liquidity needs under a wide range of potential stress scenarios, including the possible default of clearing members. The framework should include a well-documented liquidity plan, and the CCP should closely monitor and control the concentration of its liquidity risk exposure, including its exposure to the entities in the same group.

### *2.9 Investment policy*

This includes a definition of highly liquid financial instruments with minimal market and credit risk, the highly secure arrangement for the deposit of cash and other assets and the concentration limits to individual obligors.

### *2.10 Review of models, stress testing and back testing*

The Technical Standards specify a) the types of tests to be undertaken for different classes of financial instruments and portfolios, b) the involvement of clearing members or other parties in the tests; c) frequency of tests; d) the time horizons of tests; and e) the key information a CCP shall publicly disclose on its risk management model and assumptions adopted to perform its stress tests.

## **3.0 CONDUCT OF BUSINESS RULES**

### *3.1 General provisions*

When providing services to clearing members and where relevant to their clients, CCPs are required to act fairly and professionally in accordance with the best interests of such clearing members and clients and sound risk management. Also, CCPs must ensure accessible, transparent and fair rules for the prompt handling of complaints.

### *3.2 Participation requirements*

CCP clearing members are required, according to the type of product cleared, to meet certain admission criteria. These criteria should be non-discriminatory, transparent and objective so as to ensure fair and open access to the CCP and are required to ensure that the clearing members have sufficient financial resources and operational capacity to meet the obligations arising from participation in a CCP.

### *3.3 Transparency*

The CCP Technical standards do not require the disclosure of commercially sensitive information or information that would lead CCPs to competitive disadvantages, however, in order to ensure an adequate level of transparency as required under EMIR and to ensure international consistency, a number of elements need to be disclosed.

All relevant information on the functioning of the CCP shall be disclosed to clients, when these are known to the CCP, and for all other clients, this information should be passed to them upon request through their clearing member

### *3.4 Segregation and portability*

The CCP is required to maintain separate records and accounts that enable it to quickly distinguish in accounts with the CCP the assets and positions held for the account of one clearing member from the assets and positions held for the account of any other clearing members and from its own assets.

## **4.0 PRUDENTIAL REQUIREMENTS**

EMIR establishes prudential requirements for CCPs to ensure that those CCPs are secure and comply at all times with the capital requirements. Given that risks stemming from clearing activities are covered by specific financial resources, such capital requirements should ensure that the CCP is at all times adequately capitalised against credit, counterparty, market, operational, legal and business risks stemming from the non-covered activities and that it is able to conduct an orderly winding down or restructuring of its operations if necessary.

In order to ensure that the CCP would be able to organise an orderly winding-down or re-structuring of its activities, the CCP is required to hold sufficient financial resources to with-stand operational expenses over an appropriate period of time. A CCP should be able during such a period of time to set up any kind of arrangement in order to

reorganise its critical operations, including recapitalising, replacing management, revising its business strategies, cost or fee structures, restructuring the services it provides, liquidating its clearing portfolio or merging with - or transferring its clearing activities to - another CCP.

The EBA in close cooperation with the ESCB and after consulting ESMA, have developed draft regulatory technical standards specifying capital requirements for CCPs.

The MFSA will be in a position to verify that the capital of the CCP is sufficient at all times by means of capital requirement reports and the introduction of a notification threshold.

#### *4.1 Capital requirements*

A CCP is required to have a permanent and available initial capital of at least EUR7.5 million. Moreover its capital which includes its retained earnings and reserves is required to be proportionate to the risk associated from its activities. Specifically, a CCP is required to hold capital, including retained earnings and reserves, which shall be at all times more than or equal to the sum of:

- (a) the CCP's operational expenses during an appropriate time span for winding-down or restructuring its activities;
- (b) the CCP's capital requirements for **operational risk**;
- (c) the CCP's capital requirements for **credit, counterparty credit and market risks** stemming from its non-covered activities;
- (d) the CCP's capital requirements for **legal and business risks**.

Certain deductions from the capital of a CCP, such as the contributions to any default fund of another CCP would also need to be made.

Whilst a CCP may choose to hold more capital than required EMIR, in the event that the amount of capital held by a CCP turns out to be lower than the threshold of 125% of the capital requirements referred to as the notification threshold, the CCP is immediately required to notify the MFSA.

That notification shall be made in writing and need to contain the following elements:

- (a) the reasons for the CCP's capital being below the notification threshold and a description of the short-term perspective of the CCP's financial situation;
- (b) a comprehensive description of the measures the CCP intends to adopt to ensure the on-going compliance with the capital requirements.

On the basis of the information provided above, the MFSA shall decide whether to set a more stringent frequency for the CCP's reporting on its capital position with respect to the notification threshold.

Moreover, a CCP shall develop and maintain a general capital plan, to be updated annually, which shall:

- (a) specify how the CCP expects to raise new capital if its capital falls below the capital requirements;
- (b) specify how the CCP could achieve an orderly winding-down or restructuring of its activities under the Company's Act over an appropriate time span in a way that avoids any systemic disruption to the markets or institutions supported by the CCP.

In order to ensure that a CCP holds sufficient capital to ensure an orderly winding-down or restructuring of its activities, the CCP is required to provide the MFSA with an estimation of the number of months necessary to ensure such an orderly winding-down or restructuring of its clearing activities (the "winding-down period"). Such estimation should include variety of business scenarios and might be quite difficult to calculate for a CCP. Furthermore, the CCP is required to provide more details demonstrating that the estimation of the winding-down period is sufficiently prudent in any cases.

#### *4.2 Margin requirements*

In its technical standards, ESMA has defined:

- (a) the appropriate percentage above the minimum 99 per cent confidence interval that margins are required to cover;
- (b) the time horizon for the liquidation period; and

- (c) the time horizon for the look back period, i.e. the period over which the appropriate percentage should be covered, which is necessary to properly calibrate the model.

These three elements should be considered for the different classes of financial instruments cleared by the CCP and take into account the objective to limit pro-cyclicality. Finally ESMA defined the conditions under which portfolio margining practices can be implemented.

#### *4.3 Default waterfall*

The default waterfall refers to an amount of dedicated own resources, which is required to be at least equal to the 50 per cent of the capital, including retained earnings and reserves. No resources other than capital, including retained earnings and reserves can be used to comply with the said requirements.

Should the amount of the default waterfall fall below the 50% of capital, the CCP is immediately required to notify the MFSA accordingly, explaining the reason for the breach and providing a comprehensive description in writing of the measures and the timetable for the replenishment of such amount.

#### *4.4 Collateral requirements*

The CCP collects from clearing members' margin, default fund contributions and contributions to other financial resources in the form of highly liquid collateral which meet certain criteria.

The CCP is required to value this collateral by establishing and implementing policies and procedures to monitor on a near to real-time basis the credit quality, market liquidity and price volatility of each asset accepted as collateral. Such valuation policies must be reviewed at least annually. It is also required to establish clear policies for collateral value

haircuts.

Moreover, CCPs should have policies in place to ensure that concentration risk of the collateral is kept within certain limits, by sufficiently diversification in order to allow its liquidation within the defined holding period without a significant market impact. Specifically, no more than 10 per cent of its collateral is issued or guaranteed by a single commercial institutions or group of institutions. Where the CCP received more than 50 per cent of the collateral in the form of commercial bank guarantees, this limit shall be set out at 25 per cent.

## **5.0 INTEROPERABILITY ARRANGEMENTS**

Interoperability is an essential tool to achieve an effective integration of the post-trading market in Europe. However, interoperability may expose CCPs to additional risks. For this reason, regulatory approval is required before entering into an interoperable arrangement. CCPs are required to carefully consider and manage the extra risks that interoperability entails and satisfy the MFSA about the soundness of the systems and procedures adopted.

## 6.0 ADMINISTRATIVE SANCTIONS

In terms of the Financial Markets Act, a person who does not satisfy his duties as stipulated by the Act, the Legal Notices or rules issued by the Competent Authority there under may be subject to a fine imposed by the MFSA which may not exceed € 150,000.

## 7.0 CONTACTS

Should you have any queries regarding the above, please do not hesitate to contact Mr Christopher P. Buttigieg, Deputy Director, Securities and Markets Supervision Unit, email: [cbuttigieg@mfsa.com.mt](mailto:cbuttigieg@mfsa.com.mt), or Mr Edward Grech, Analyst, Securities and Markets Supervision Unit email – [egrech@mfsa.com.mt](mailto:egrech@mfsa.com.mt).