



**SELF ASSESSMENT OF MEFF  
SOCIEDAD RECTORA DE PRODUCTOS  
DERIVADOS AGAINST THE CPSS –  
IOSCO RECOMMENDATIONS FOR  
CENTRAL COUNTERPARTIES**

**Answers to the key questions of Recommendations for  
Central Counterparties (CCPs)**

The information provided in the answers is accurate as of 3 August 2011



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3 August 2011

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## 1. BRIEF INTRODUCTION TO THE CCP

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### Scope of coverage. Objective

The assessment is focused on MEFF Sociedad Rectora de Productos Derivados, S.A.U. (hereinafter "MEFF") only, as the main CCP active in the Spanish financial markets.

Where relevant, this assessment takes into account the fact that MEFF is a wholly owned subsidiary of BME Group (Bolsas y Mercados Españoles S. A.)

Through the MEFF CCP, participants are offered clearing of physical and financial derivatives traded on the MEFF Exchange both on electronic order books and off order books. It also provides a broad range of services for repos and power derivatives contracts.

**Objective:** To assess whether the methods used by MEFF to manage the risks it faces as central counterparty (CCP) comply with the internationally recognized "Recommendations for Central Counterparties" developed jointly by the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO).

### Ownership

MEFF is an official secondary derivatives market under Spanish Law that runs both an Exchange and a CCP. MEFF opened for business in November 1989 and became part of Bolsas y Mercados Españoles (BME) when this Group was created in 2002 ([www.bolsasymercados.es](http://www.bolsasymercados.es))

MEFF is a 100% owned subsidiary of the BME Group, the parent company. The BME Group is a public company listed on the Spanish Stock Exchange.

### Regulatory structure

MEFF is an exchange and CCP for financial futures. It is fully regulated and supervised by the Spanish financial authorities: Comisión Nacional del Mercado de Valores (CNMV) and the Ministerio de Economía y Hacienda.

The CCP is governed and managed by MEFF as part of the activities of the company.

MEFF activities are regulated by the Securities Market Act 24/1988, of 28 July, and the Royal Decree 1282/2010, of 15 October.

The MEFF Rule Book has been approved and published on the Spanish Gazette on 5 January 2011. The Rule Book and regulations became effective on 24 January 2011 and it can be looked up on the MEFF website at the Rules and Regulations section.

The General Conditions of the Contracts, Circulars and other regulations have been approved by the Spanish Supervisor (CNMV). Members of the market, clients and users of the services provided by MEFF must comply with all this legislation.

### Basic transaction data

MEFF cleared 70.3 million contracts in 2010. These trades have a notional value of €788,091 million.

MEFF repo clearing segment has approximately €27.7 billion of outstanding positions as of December 2010.



## **Institutional and market structure**

Equity derivatives trading is undertaken via the MEFF Exchange, cleared by MEFF (as CCP), and settled by delivery or in cash.

Repo trading on Spanish Government Bonds is undertaken via Multilateral Trading Facilities (SENAF), bilateral trading systems, voice brokers, etc., cleared by MEFF as CCP and settled at IBERCLEAR as securities settlement system (SSS).

Power derivatives are traded bilaterally and in the OTC markets, with clearing taking place at MEFF as CCP. All instruments are cash-settled.

Products are grouped in segments. The criteria to assign a product to a segment are (i) risk profile; and (ii) type of underlying. There are three segments: Financials, repo (MEFFRepo), energy (MEFFPower). Each segment has its own segregated Clearing Fund.

## **Participants**

MEFF has over 100 members. All of them are from Europe and North America.

MEFF has the following member categories:

- **Non-Clearing Members.** These members may trade or request the Registration of Contracts for their proprietary account or on behalf of their clients, and must enter into an agreement with at least one General Clearing Member.
- **Proprietary Non-Clearing Members.** These members may, exclusively, trade or request Registration of Contracts for their proprietary Account or for the Accounts of their group entities, and must enter into an agreement with at least one General Clearing Member.
- **Individual Clearing Members.** This category enables the Member to trade or request Registration of Contracts for its proprietary account or on behalf of its clients. An Individual Clearing Member shall be liable to MEFF for compliance with all obligations to the contracts and trades registered in its accounts.
- **General Clearing Members.** As well as the duties inherent to Individual Clearing Members, a General Clearing Member shall be liable to MEFF for full compliance with all obligations inherent to the Contracts registered in the accounts of its Non-Clearing Members and registered in the accounts of its Proprietary Non-Clearing Members.

## **Information and methodology used for the assessment**

The assessment uses the recommendations and the methodology developed jointly by the CPSS and IOSCO as set out in their report entitled "Recommendations for Central Counterparties" published in November 2004.

The main source of information used in making the assessment was MEFF's own documentation, the MEFF Rule Book, the General Conditions of the Contracts, the Circulars, and the cumulative knowledge and experience from its activity.

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## 2. ANSWERS TO THE KEY QUESTIONS OF THE RECOMMENDATIONS

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### Executive summary

This is the first published assessment of MEFF against the CPSS-IOSCO recommendations for CCPs. These recommendations represent an internationally developed and agreed minimum standard of good practice that systemically important CCPs should seek to achieve.

MEFF fully observes all 13 of the applicable recommendations. The recommendations number 11 and 15 are Not Applicable.

### Recommendation by recommendation assessment of observance

#### Recommendation 1: Legal Risk

**A CCP should have a well founded, transparent and enforceable legal framework for each aspect of its activities in all relevant jurisdictions.**

#### Key questions

**Question 1.** Are the laws and regulations governing the operation of the CCP and the rules, procedures, and contractual provisions for its participants clearly stated, internally coherent, and readily accessible to participants and the public?

*As a private limited company incorporated in Spain, MEFF is subject to Spanish company law. Also, as the official secondary exchange for financial futures and options MEFF is fully supervised by the CNMV and the Ministerio de Economía y Hacienda.*

*MEFF is subject to the Securities Market Act 24/1988, of 28 July, and the Royal Decree 1282/2010, of 15 October.*

*The MEFF Rule Book covering the structure, functioning, trading and rules for managing financial instruments traded and/or settled on MEFF was approved by a resolution of the CNMV (Comisión Nacional del Mercado de Valores) on 21 December 2010 and published on 5 January 2011.*

*There is no evidence that the applicable legislation, regulations and rules are not internally consistent.*

*All regulations mentioned are freely available on the websites of the CNMV and MEFF.*

**Question 2.** Does the legal framework demonstrate a high degree of assurance that there is a clear and effective legal basis for:

- The CCP to act as counterparty, including the legal basis for novation or open offer.
- The timing of assumption of liability as CCP.
- Netting arrangements.

- The CCP's interest in collateral (including margin) that a participant pledges or transfers to the CCP.
- Default procedures.
- Finality of transfers of funds and financial instruments.
- Other significant aspects of the CCP's operations, risk management procedures and related rules.

*The legal framework (the Spanish Securities Market Act 24/1988, the Royal Decree 1282/2010 and the MEFF Rule Book) demonstrates a high degree of assurance that there is a clear and effective legal basis for all of the CCP's operations and risk management procedures.*

*Further assurance on finality issues is provided by MEFF's designation under the Payment Systems and Securities Settlements Law 41/99, of 12 November (Ley 41/99 de 12 de Noviembre, sobre Sistemas de Pagos y Liquidación de Valores), implementing the EU Settlement Finality directive in Spain (Directive 98/26/EC). These regulations reduce the risks associated with participation in designated payment systems (MEFF is specifically named in Article 8 g) by minimizing the disruption caused by insolvency proceedings against certain participants in the system.*

**Question 3.** Are the rules, procedures and contracts of the CCP enforceable when a CCP participant defaults or becomes insolvent? Is there a high degree of assurance that actions taken under such rules and procedures may not later be stayed, avoided or reversed?

*The rules, procedures and contracts of the CCP are enforceable even in the case of insolvency of a CCP participant.*

*There is a high degree of assurance that actions taken under such rules and procedures may not later be stayed, avoided or reversed. Article 59 of the Securities Market Act, in Chapter IV Official Secondary Markets for Futures and Options Represented by Book Entries, in points number 8 and 9 provides the CCP with the rules to manage the bankruptcy and insolvency procedure establishing the absolute right of separation of the financial instruments and cash posted by the member as margins, in accordance with the regulations provided in the MEFF Rule Book.*

*All the default rules are protected by the Chapter IV of the Securities Market Act. Given the protections afforded by the Law, we do not believe there is any significant risk that the actions taken by MEFF in managing a future default would be subject to a successful legal challenge.*

**Question 4.** Is there a significant level of cross-border participation in the CCP? Has the CCP determined whether there are other jurisdictions relevant for determining the adequacy of the legal framework? Has the legal framework been evaluated for the other relevant jurisdictions? Do laws and rules support the design of any cross-border arrangement and provide adequate protection to both CCPs in the operation of the arrangement? Are there conflicts of laws issues and, if so, have they been addressed? Have cross-border collateral arrangements been evaluated?

*There is a significant level of cross-border participation in the CCP.*

*All agreements, contracts, members and rules are subject to Spanish Law and the resulting legal risk is minimised through the holding of collateral and stock in countries where MEFF is comfortable with local enforceability and local insolvency laws.*

*Cross-border collateral arrangements are being evaluated through the obtained legal opinions.*

## **Recommendation 2: Participation requirements**

**A CCP should require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the CCP. A CCP should have procedures in place to monitor that participation requirements are met on an ongoing basis. A CCP's participation requirements should be objective, publicly disclosed, and permit fair and open access.**

## Key questions

**Question 1.** Does the CCP establish requirements for participants' financial resources and creditworthiness? If so, how? What factors are considered (for example, size, clearing for indirect participants, products cleared)? Does the CCP assess participants' operational capability? If so, how? What factors are considered (for example, arrangements to meet payment obligations, risk management policies, staffing, internal audit of risk controls and IT systems)?

*MEFF has established minimum requirements for members which vary depending on the segments (group of contracts) to be cleared and the type of membership.*

*For example, MEFF sets minimum requirements for each type of member for core capital in terms of size. The required minimum levels of equity core capital applicable are:*

- a) Proprietary Non-Clearing Member. €100,000*
- b) Non-Clearing Member authorized by MEFF to manage segregated accounts: €18MM.*
- c) Individual Clearing Member authorized by MEFF to manage segregated accounts: €75MM*
- d) General Clearing Member without authorization to manage a second-tier register: €100MM.*
- e) General Clearing Member authorized by MEFF to manage segregated accounts: €125MM.*
- f) Member authorized by MEFF to manage segregated and non-segregated accounts: €500MM.*

*The CCP evaluates the operational capability of the participants. The method to analyze the operational capacity considers:*

- the type of company and structure*
- ownership*
- country of residence*
- trading experience*
- knowledge of markets and products*
- staff with appropriate experience and training*
- arrangements to meet payment obligations to MEFF*
- arrangements to meet collateral and delivery obligations to MEFF*
- risk management*
- backoffice routines.*

*All Clearing Members must have money settlement arrangements with the Target 2 system, through which cash margin payments to and from MEFF, and cash settlements are made.*

*In addition, all members must have the necessary CSD or SSS facilities to meet their delivery obligations.*

**Question 2.** Does the CCP monitor that participation requirements are met on an ongoing basis? If so, how? Through access to regulatory reports or directly? Are reports sufficiently timely to be useful for monitoring purposes? Under what conditions can the CCP suspend and terminate participants' membership? What arrangements does the system have in place to facilitate the suspension and orderly exit of participants that no longer meet the participation requirements?

*The participants' activity is monitored through the information required by MEFF to the participants.*

*MEFF pays particular attention to the credit rating, the credit rating outlook and all financial information available (like share price, earnings, corporate events,...) of all participants. Also, MEFF is entitled to require all information it finds necessary to continuously evaluate the participants' financial standing, ratings, level of competence and any other matter relevant, and the participants are obliged to disclose this information.*

*A member may be subject to suspension, in accordance with the provisions of the article 29 of the MEFF Rule Book, from the moment when there are signs that the Member incurs in any cause of Default provided in the article 27, in relation to the capacities of the Member in those Contract Groups where signs of a cause of Default exist, or where such Default is relevant. Also, any breach by the member of the obligations provided in the Rule Book, in the General Conditions, in the Circulars or in the agreement with MEFF will be cause of suspension.*

*A suspended participant will be disabled in the CCP. MEFF shall inform the CNMV and the relevant Competent Authorities of the start of actions relative to an eventual declaration of Default. These arrangements prevent the participant from continuing clearing in the CCP, and stop application for clearing of trades from the bilateral market and the OTC market.*

**Question 3.** Do participation requirements limit access on grounds other than risks? Are they objective and do they permit fair and open access? Are participation requirements, including arrangements for orderly exit of participants, clearly stated and publicly disclosed?

*For applicants fulfilling requirements to participate in the CCP, participation is not denied on other grounds than risk. MEFF publishes minimum membership requirements in the MEFF Rule Book; access is fair and open for any applicant meeting the requirements.*

*The MEFF Member Relations Department manages the member requirement protocol to access and suspend or terminate its business relationship with any member. That protocol includes a letter from the member asking for the termination of the membership in case of voluntary exit after having fulfilled all financial obligations.*

*In case of exit due to member's default, the procedures are clearly stated in the Rule Book.*

### **Recommendation 3: Measurement and management of credit exposures**

**A CCP should measure its credit exposures to its participants at least once a day. Through margin requirements, other risk control mechanisms or a combination of both, a CCP should limit its exposures to potential losses from defaults by its participants in normal market conditions so that the operations of the CCP would not be disrupted and non-defaulting participants would not be exposed to losses that they cannot anticipate or control.**

#### **Key questions**

**Question 1.** How frequently does the CCP measure its exposures to its participants? Does the CCP have the capacity to measure exposures intraday? How timely is the information on prices and positions that is used in these calculations?

*The potential exposure of the CCP's participants is measured at least once every 5 minutes.*

*MEFF has the capability to monitor and control intra-day register contracts and recalculate initial and variation margin using real time prices, either routinely or ad-hoc at any time intraday.*

*All intraday margin calculations are based on real time positions and prices.*

**Question 2.** How does the CCP limit its exposures to potential losses from defaults by its participants? If margin requirements are used, does the CCP observe Recommendation 4? If not, how does the CCP ensure that closing out any participant's positions in normal market conditions would not disrupt the operations of the CCP or expose non-defaulting participants to losses that they cannot anticipate or control?

*MEFF uses margin requirements to control exposures of its participants. Additionally to the margin requirements MEFF has established market risk limits.*

*MEFF observes Recommendation 4.*

*Although MEFF's margin requirements are central to its risk management, MEFF also has other measures at its disposal:*

- *Individual guarantee funds required from clearing members.*
- *Additional initial margin requirements for large positions.*
- *Daily stress test of the Default fund.*
- *Prior authorization of trades above a certain size*
- *Issue instructions to reduce positions*

*In addition MEFF does a credit rating evaluation of all new participants and a regular credit rating evaluation of all participants.*

## **Recommendation 4: Margin requirements**

**If a CCP relies on margin requirements to limit its credit exposures to participants, those requirements should be sufficient to cover potential exposures in normal market conditions. The models and parameters used in setting margin requirements should be risk-based and reviewed regularly.**

### **Key questions**

**Question 1.** What is the intended coverage of margin requirements? What is the time interval over which potential price movements are measured? Is the interval consistent with a reasonable assumption about how quickly a defaulting participant's positions could be closed out? How does the CCP validate the models and parameters used to determine the margin levels consistent with the intended coverage? How frequently does it review and validate the models?

*Margin requirements are based on price changes over a given close-out period for each underlying group of contracts within a confidence level of 99.9%.*

*MEFF establishes margin rates based on observed volatility for the underlying financial instrument in the cleared market, using close-out periods of at least 2 days.*

*The close-out period is based on a professional assessment and a reasonable assumption of the maximum time the CCP would need to close-out the portfolio without a significant price influence in the market caused by this operation.*

*MEFF uses its own proprietary margin model, MEFFCOM2, developed in 1989 and adapted as needed. The model is similar to the "SPAN" model developed by the Chicago Mercantile Exchange. The margin model is fully explained in a Circular. Margin parameters are also published by circular.*

*The margin model and all risk control models and procedures are contained in a confidential Risk Report regularly submitted to the national supervisor (CNMV) and reviewed as needed.*

*MEFF controls on a daily basis the adequacy of the margin parameters in relation with the intended coverage. Additional back-testing and stress testing are performed regularly.*

**Question 2.** Does the CCP have the authority and operational capacity to demand margin intraday to maintain the desired coverage? Under what circumstances?

*MEFF has the authority and operational capacity to calculate and to demand margin intraday when this is deemed necessary. Clearing Members must post Extraordinary Margins and MEFF may require these margins for each Contract Group, either individually to a Clearing Member or generally to all Clearing members, in cases which MEFF considers to be of a high-risk.*

*According to the MEFF Rules, the CCP can decide to demand an intraday margin whenever the price of one or several underlying financial instrument reaches the Price Fluctuation Limit, established by MEFF at 80% of the initial margin parameter. When this circumstance occurs, the CCP requires the Clearing Member to meet the margin call.*

**Question 3.** What types of assets does the CCP accept as margin? What types are actually held? How frequently are the assets revalued? Are haircuts applied that adequately reflect the potential for declines in asset values between the last revaluation and liquidation?

*MEFF accepts cash, on-demand bank guarantees (under extremely restrictive conditions and for energy derivatives only), sovereign bonds from certain countries, and Spanish stocks as margin. MEFF has the discretion to decline any type of collateral used by its members.*

*All margin calculations are done on individual account level and securities used as collateral are revalued at least on a daily basis.*

*MEFF established a prudent collateral haircut policy and the Risk Management department regularly reviews the adequacy of the haircuts. MEFF uses the haircuts established by the European Central Bank as a minimum but the Risk Management Committee can decide to increase the haircuts to reflect the market risk in the relevant securities, taking into consideration volatility and liquidity issues.*

## **Recommendation 5: Financial resources**

**A CCP should maintain sufficient financial resources to withstand, at a minimum, a default by the participant to which it has the largest exposure in extreme but plausible market conditions.**

### **Key questions**

**Question 1.** Has the CCP established procedures to stress test its exposures in extreme but plausible market conditions? What scenarios are evaluated? Do the scenarios include the most volatile periods that have been experienced by the markets for which the CCP provides services? Does the CCP have sufficient resources in the event of default by the participant with the largest exposure? Has the potential for multiple simultaneous defaults been evaluated? Are stress tests performed at least monthly, with a comprehensive reconsideration of models, parameters and scenarios occurring at least annually? Does the CCP have a clear policy on actions to be taken in the event that stress testing results indicate resources are not likely to be adequate to meet its obligations resulting from a default? Has it adhered to that policy? Is the policy made available to participants and authorities?

*MEFF has established procedures to stress test its exposures in extreme but plausible market conditions. Daily price movements are monitored closely by the risk management team and scenarios are updated with new extreme assumptions as appropriate. MEFF always considers a variety of market scenarios.*

*The scenarios include the most volatile two-day periods that have been experienced ten years back in time. If the Risk Management Committee considers that some particular event should be included after the ten years, the period could be enlarged up to fifteen years back in time.*

*MEFF has sufficient resources to manage the default of the participants, even in the event of multiple simultaneous defaults. Stress tests are performed and evaluated by the risk department on a daily basis and a summary of the stress test exposure is provided to the Risk Management Committee at least monthly.*

*A comprehensive reconsideration of models, parameters and scenarios is done at least on a monthly basis. Assumptions are disclosed to authorities and members.*

**Question 2.** What are the types and values of resources that the CCP has available to cover losses from participants' defaults? Is there a high degree of assurance that the CCP will be able to draw on those resources for the anticipated value in the event of a participant's default? Do the CCP's rules prohibit them from being used to cover operating losses or losses from other CCP activities?

*In case MEFF has to cover losses from a participant's defaults, there is a high degree of assurance that the CCP will be able to draw on its resources to manage the situation. The MEFF Rule Book establishes the Default Waterfall of Resources available. This line of defense consists of:*

- 1. Initial Margins of the Member for each group of contracts. Covers a 99.9% confidence interval with a close-out period of at least 2 days.*
- 2. Defaulting Member's contribution to the default fund for each group of contracts. The total default fund of each group of contracts must cover the risk of the riskiest CM, plus an additional 10%.*
- 3. Offsetting balances for each group of contracts and execution of the defaulting member's extraordinary and individual fund.*
- 4. MEFF fund for each contract group. This amount will be at least equal to the maximum CM minimum contribution for each group of contracts.*
- 5. Remainder of the default fund in the group with losses (The default fund from the groups of contracts with no default will never be affected)*
- 6. MEFF Equity.*

*As of 31 December 2010, MEFF Group, had a combined equity of €52.4MM. Bolsas y Mercados Españoles (BME Group), the 100% owner of MEFF Group, has an equity of €448.4MM.*

*In the event of default, the Member's proprietary account position will be closed and the clients positions will be transferred to other members. Defaults are managed through two main principles:*

- Cross Default. If a Member defaults and it participates in several segments, the Member is considered to default in all segments. The Initial margins and Individual margins provided specifically for a segment may be used to cover other segment losses.*
- No Contamination between segments. The losses which may occur in a segment can not affect the Default Fund of a segment in which the defaulting member did not participate or where losses have not occurred.*

**Question 3.** Are any of the resources that the CCP is relying upon to cover losses from defaults not immediately available to meet the CCP's obligations? If so, has the CCP obtained committed credit lines subject only to presentment that allows it to borrow against those assets? If so, can those lines be drawn upon sufficiently quickly to ensure that the CCP can meet its obligations when due?

*Around 80% of the total amount of the margins are posted in cash on the MEFF account at Target 2 and invested by MEFF in immediately available Repos.*

*Enforcement of the Guarantees, as the case may be, shall take place in accordance with the provisions of Royal Decree Law 5/2005 and development regulations thereof.*

*If MEFF needs to enforce guarantees that have been posted as securities, it may use up to 10% of the*

*guarantees amount that has been deposited as cash, for the period between the date on which the securities are sold in an official secondary market and the actual settlement of that sale transaction, so that the settlements referred to in Article 21 of the Rule Book can be effected without problem, and this circumstance shall be notified to the Comisión Nacional del Mercado de Valores.*

*These resources can be drawn upon sufficiently quickly to ensure that MEFF can meet its obligations.*

## **Recommendation 6: Default procedures**

**A CCP's default procedures should be clearly stated, and they should ensure that the CCP can take timely action to contain losses and liquidity pressures and to continue meeting its obligations. Key aspects of the default procedures should be publicly available.**

### **Key questions**

**Question 1.** Do the CCP's default procedures state clearly what constitutes a default? If a default occurs, do the CCP's default procedures provide it with authority to promptly close out or manage the positions of a defaulting participant and to apply the defaulting participant's collateral or other resources? Do the CCP's procedures, or mechanisms other than those of the CCP, permit the transfer or (as an alternative) liquidation of the positions and margin of customers of the defaulting participant? Do the procedures empower the CCP to draw promptly on any financial resources?

*The MEFF Rule Book clearly establishes what constitutes a default and provides MEFF with the authority to manage the default to promptly close out or manage the positions of a defaulting participant, and to use the defaulting participant's collateral and other resources.*

*Default procedures, clearly established in the MEFF Rule Book, provide the CCP with the authority to manage, transfer or liquidate the positions and margins of customers of the defaulting participant. MEFF has the right to transfer client positions of the defaulting Clearing Member to another Clearing Member. Also, MEFF has the right to transfer the positions of the Non-Clearing Members.*

*The procedures empower the CCP to draw sufficiently quickly on any financial resources to ensure that MEFF meets its obligations.*

**Question 2.** Does the legal framework provide a high degree of assurance that the decisions to liquidate or transfer a position, to apply margin or to draw down liquidity resources in the event of the insolvency of a participant would not be stayed or reversed? Does national insolvency law permit identification and separate treatment of customer and proprietary assets?

*The applicable law and regulations provide a high degree of assurance that the decisions to liquidate or transfer a position, to apply margin or to draw down liquidity resources in the event of insolvency of a participant would not be stayed or reversed.*

*Article 59 of the Securities Market Act, paragraphs 8 and 9, provides the CCP with the rules to manage the bankruptcy and insolvency procedure establishing the absolute right of separation of the financial instruments and cash posted by the member as margins, as well as identification and separate treatment of the customer and proprietary assets, all in accordance with the regulations provided in the MEFF Rule Book.*

**Question 3.** Does the CCP's management have internal plans for implementing its default procedures? Does the plan maintain a measure of flexibility for the CCP in deciding how best to implement its default procedures? Does the plan address the need for coordination in cases where

more than one CCP, authority or a separate market operator is involved? How frequently is the plan reviewed?

*MEFF management has an internal plan for implementing its default procedures. The plan clearly defines roles and responsibilities to manage the default procedures. The Annex 9 of the MEFF Risk Report provides the CCP management with the internal plan to implement the default procedures.*

*The MEFF policy is a general outline for managing different situations and maintains flexibility for the CCP in deciding how to best implement default procedures. The internal plan establishes step by step procedures to coordinate, inform, register, decide, communicate, and manage a default.*

*The policy is reviewed by the Risk Management Committee on a yearly basis. The Risk Management Committee communicates the information to the Management Committee and to the Board and supervisors as appropriate.*

**Question 4.** Are the key aspects of the default procedures (specified in paragraph 4.6.9) publicly available?

*The key aspects of the default procedures (specified in Recommendation 5) are provided in the MEFF Rule Book and are publicly available on the website. However, the risk management routines and the daily stress test results are not publicly available. Also, the Risk Management Committee does not make publicly available the internal plans to manage the default procedures.*

## **Recommendation 7: Custody and investment risks**

**A CCP should hold assets in a manner whereby risk of loss or of delay in its access to them is minimised. Assets invested by a CCP should be held in instruments with minimal credit, market and liquidity risks.**

### **Key questions**

**Question 1.** At what types of entities is collateral held? Does the CCP verify that these entities' procedures and practices conform to Recommendation 12 of RISS? If so, how? Does the CCP confirm that its interest in the securities can be enforced and that it can have prompt access to the securities in the event of a participant's default, even if these securities are held in another time zone or jurisdiction? Does it monitor the financial condition of its custodians on an ongoing basis?

*MEFF accepts collateral in the form of cash deposits at an European Central Bank Target 2 system proprietary own account. MEFF holds non-cash collateral in CSD's (Iberclear and Clearstream). There is no evidence that any of these institutions' (ECB, Iberclear and Clearstream) procedures and practices are not conforming to Recommendation 12 of the CPSS-IOSCO Recommendations for Securities Settlement Systems.*

*MEFF has direct access to the Target 2 system and to Iberclear and Clearstream system with clear defined delivery obligations and no use of intermediary custodian entities.*

**Question 2.** How is cash invested? Are investments secured? What standard does the CCP use to ensure that obligors are highly creditworthy? What standard does the CCP use to ensure that investments have minimal market and liquidity risks?

*Cash is invested in Sovereign Bonds through Overnight Repos (repurchase agreements). The investments have minimal market and liquidity risks.*

**Question 3.** Does the CCP consider its overall exposure to an obligor in choosing investments? Are investments limited to avoid concentration of credit risk exposure? If so, how?

*In making its investment decisions, MEFF considers its overall credit risk exposure towards any single individual obligor, and ensure that the level of its overall exposure remains within acceptable concentration limits.*

*MEFF monitors and controls its overall concentration of credit risk exposure following the Bank of Spain established parameters.*

## **Recommendation 8: Operational risk**

**A CCP should identify sources of operational risk and minimise them through the development of appropriate systems, controls and procedures. Systems should be reliable and secure, and have adequate, scalable capacity. Business continuity plans should allow for timely recovery of operations and fulfilment of a CCP's obligations.**

### **Key questions**

**Question 1.** Does the CCP have a process for actively identifying, analysing and addressing its operational risk, including risks arising from its outsourced operations and its other activities?

*The CCP has a process for actively identifying, analysing and addressing its operational risk, including risks arising from its outsourced operations and its other activities. The Incidents Committee meets weekly and it is key for identifying, analyzing and addressing operational risk. This Committee reports to the Management Committee,*

Question 2. Does the CCP have a business continuity plan that addresses events posing a significant risk of disrupting operations? Do plans ensure that critical information can be recovered in a timely manner? Do plans provide, at a minimum, for the recovery of all transactions at the time of the disruption to allow systems to continue to operate with certainty? Is the business continuity plan regularly reviewed and tested with participants? Have appropriate adjustments to operations been made based on the results of such exercises?

*All MEFF key departments have appropriate Business Continuity Plans that address a long list of events posing a significant risk of disrupting operations.*

*Three main departments; Technology, Market Services and Supervision, and Clearing do have a Business Continuity Plan to ensure that critical information and systems can be recovered within a very short time.*

*The plan is tested at least 7 times per year to ensure the business is not interrupted in terms of the systems and the service.*

*Appropriate adjustments have been made as a result of the tests.*

**Question 3.** Are there adequate management controls and sufficient (and sufficiently well qualified) personnel to ensure that procedures are implemented appropriately? Are operational reliability issues reviewed regularly by senior management, including review by persons not responsible for the relevant operations? Is there an internal audit function and does it review operational risk controls?

*The Incidents Committee is responsible for assessing the appropriateness of internal controls, and also responsible for the development and implementation of the Business Continuity Plan.*



*At least once a year, MEFF has an external audit review where both senior management and internal auditor review the operational risk controls.*

*Additionally, MEFF and MEFF Members participate in the Disaster Recovery Test organized by the Technology Division of the FIA (Futures Industry Association).*

**Question 4.** How many times during the last year has a key system failed? What is the most common cause of failures? How long did it take to resume processing? How much transaction data, if any, were lost? How does the CCP ensure the integrity of messages? Does the CCP have capacity plans for key systems and are key systems tested periodically to determine if they can handle stress volume?

*MEFF has experienced no major operational disturbances in the key system during 2010 – 2011*

*There is no evidence from the technical and operational data that key systems are not secure or unable to maintain the transaction data even with extreme volume conditions or stress conditions.*

*MEFF runs technical system stress tests to ensure the integrity of the transactions.*

### **Recommendation 9: Money settlements**

**A CCP should employ money settlement arrangements that eliminate or strictly limit its settlement bank risks, that is, its credit and liquidity risks from the use of banks to effect money settlements with its participants. Funds transfers to a CCP should be final when effected.**

#### **Key questions**

**Question 1.** Does the CCP use the central bank model or the private settlement bank model?

*MEFF uses the European Central Bank Target 2 system. .*

**Question 2.** Do the CCP's legal agreements with its settlement bank or banks provide that funds transfers to its accounts are final when effected? Do the laws of the relevant jurisdictions support these provisions? Do the payment systems for the currencies used support intraday finality? Does the CCP routinely confirm that funds transfers have been effected as and when required by those agreements?

*MEFF does not use a private bank's settlement model.*

*MEFF is regulated by the Payment Systems and Equity Settlements Law 41/99, of 12 November (Ley 41/99 de 12 de Noviembre, sobre Sistemas de Pagos y Liquidación de Valores), implementing the EU Settlement Finality Directive in Spain (Directive 98/26/EC). These regulations reduce the risks associated with participation in designated payment systems.*

**Question 3.** If the private settlement bank model is used, does the CCP establish and monitor strict criteria for the banks used that address their creditworthiness, access to liquidity, and operational reliability?

*Not Applicable.*

**Question 4.** If the private settlement bank model is used, does the CCP actively monitor the concentration of exposures among the settlement banks, and routinely assess its potential losses and liquidity pressures from a settlement bank's failure?

*Not Applicable.*

## **Recommendation 10: Physical deliveries**

**A CCP should clearly state its obligations with respect to physical deliveries. The risks from these obligations should be identified and managed.**

### **Key questions**

**Question 1.** Does the CCP have rules that clearly state its obligations with respect to deliveries of physical instruments?

*MEFF has rules to manage the obligations with respect to delivery of physical instruments. The rules are included in the General Conditions of the Contracts. In the case of physical delivery of the equity futures and options, it is carried out through stock exchange transactions, settled at the CSD. In the case of physical delivery of the MEFF Repo segment, deliveries are performed at the CSD.*

**Question 2.** Does the CCP have obligations to make or receive deliveries of physical instruments? If yes, does the CCP use DVP mechanisms that eliminate principal risk? If no DVP mechanism is available, does the CCP take other steps to mitigate principal risk?

*All the obligations to make or receive deliveries of physical instruments are included in the specific General Conditions of each group of contracts and all of them are publicly disclosed.*

- *The MEFF Repo segment uses Delivery versus Payment for the settlement at the CSD (Iberclear). Due to the process, MEFF eliminates principal risk.*
- *The MEFF Futures and Options financial segment uses Delivery versus Payment for the settlement at the CSD. Under this process, MEFF eliminates principal risk.*
- *MEFF does not have obligations to make or receive deliveries of physical instruments in the Power segment.*

**Question 3.** Has the CCP identified the liquidity, storage and delivery (other than principal) risks to which it is exposed because of the delivery obligations that it assumes? Does the CCP take steps to mitigate these risks? What steps does it take?

*The CCP has identified the liquidity and delivery risks to which it is exposed as very low. There is no storage risk.*

## **Recommendation 11: Risks in links between CCPs – Not Applicable**

**CCPs that establish links either cross-border or domestically to clear trades should evaluate the potential sources of risks that can arise, and ensure that the risks are managed prudently on an ongoing basis. There should be a framework for cooperation and coordination between the relevant regulators and overseers.**

## **Recommendation 12: Efficiency**

**While maintaining safe and secure operations, CCPs should be cost-effective in meeting the requirements of participants.**

### ***Key questions***

**Question 1.** Does the CCP have in place procedures to control costs (for example, by benchmarking its costs and charges against other CCPs that provide a similar service and by analysing the reasons for significant differences)? Does the CCP have in place procedures to regularly review its pricing levels against its costs of operation?

*The performance of MEFF is reviewed by the Board of Directors on a monthly basis.*

*Comparison of charges for MEFF services against competitors is evaluated on an ongoing basis by the Management Committee.*

*The annual budget is reviewed and approved by the Management Committee, the Board of Directors and the BME Group, and it is submitted to the regulator for review.*

**Question 2.** Does the CCP regularly review its service levels (for example, by surveying its participants)? Does the CCP have in place procedures to regularly review operational reliability, including its capacity levels against projected demand?

*MEFF regularly reviews its service level and adjust the service offer based on customer demands. MEFF is in a constant contact with the participants, meeting regularly with them, and has in place procedures to review capacity levels against projected demand.*

*The Advisory Working Group where all major Clearing Members are represented meets at least once a year to review the CCP services and the risk management procedures in place.*

*MEFF price list is public and available on MEFF website. [www.meff.com](http://www.meff.com)*

## **Recommendation 13: Governance**

**Governance arrangements for a CCP should be clear and transparent to fulfil public interest requirements and to support the objectives of owners and participants. In particular, they should promote the effectiveness of a CCP's risk management procedures.**

### ***Key questions***

**Question 1.** What are the governance arrangements for the CCP? What information is publicly available about the CCP, its ownership and its board and management structure?

*MEFF Sociedad Rectora de Productos Derivados S.A.U is a 100% owned subsidiary of the BME Group, the parent company. The BME Group is a public company listed on the Spanish Stock Exchange. The governance arrangement is clearly specified and the information is publicly available in the annual report of the BME Group on the Group website [www.bolsasymercados.es](http://www.bolsasymercados.es)*

*Members of the MEFF Board are appointed by the sole shareholder, BME Group. Members of the BME parent company are designated at the Annual General Meeting of shareholders.*

*The Group supports the highest standards in corporate governance. All the information regarding the corporate governance is in the Corporate and Social Responsibility Report publicly available in the Investors Corner of the website.*

**Question 2.** Is there a clear separation in the reporting lines between risk management and other operations of the CCP? How is this separation achieved? Is there an independent risk management committee?

*The Risk Management Committee is chaired by the MEFF CEO. The Members of the Risk Management Committee are the two Deputy CEO's and the CCP Managing Director. The decisions taken by this Committee are reported to the Board of Directors for approval (margin parameters and risk management criteria) or for information as appropriate, by the CEO. The Management Committee is duly informed of the decisions of the Risk Management Committee.*

**Question 3.** What steps are taken to ensure that management and the board have the adequate skills and incentives to achieve the CCP's objectives of delivering sound and effective services and to meet related public interest requirements? What are the mechanisms the board has in place to ensure that the objectives include delivering sound risk management and meeting related public interest requirements? How are management and the board made accountable for their performance? How is the composition of the board determined? Are there mechanisms to ensure that the board contains suitable expertise and takes account of all relevant interests? Are reporting lines between management and the board clear and direct? Is the board responsible for selecting, evaluating and if necessary, removing senior management?

*The members of the Board of Directors both MEFF Board and the BME Group Board are individuals with expertise in financial markets, risk management, accounting, IT systems and other relevant fields. Management is recruited based on their actual competence within the business, adequate skills and the perspective of further growth in the business.*

**Question 4.** Are the CCP's objectives, those responsible for meeting them and the extent to which they have been met disclosed to owners, participants and public authorities? If so, what/who are they?

*MEFF operates in accordance with a business plan and with a yearly budget. MEFF objectives are available to the Board and to the BME Group.*

*BME Group clearly makes publicly available its ownership structure and composition of the Group Board of Directors and the Board of Directors Committees. The website also contains publicly relevant information to investors (quarterly results, dividends, share value monitor, results publication schedule, and share evolution details).*

## **Recommendation 14: Transparency**

**A CCP should provide market participants with sufficient information for them to identify and evaluate accurately the risks and costs associated with using its services.**

### **Key questions**

**Question 1.** Does the CCP disclose to market participants its rules and regulations, relevant laws, governance procedures, risks, steps taken to mitigate risks, the rights and obligations of participants and the costs of using the CCP services? Does the CCP make clear when and in what circumstances it assumes counterparty exposure and any restriction or limitations on its fulfilment of its obligations? Does the CCP disclose appropriate quantitative information on its clearing, netting and settlement

activities? Does the CCP provide market participants with sufficient information on default procedures and stress testing?

*The CCP provides market participants with sufficient information necessary to evaluate the risks and costs of using its services.*

*MEFF publishes its rules and procedures for the various markets cleared, together with information on risk management, transaction fees, clearing fees, procedures and rules regarding contributions to the Default Funds. MEFF does not make information relating to stress tests public.*

**Question 2.** How is information made available? In what language or languages? In what form?

*The rules and procedures, etc., are published in both Spanish and English on the internet.*

*All the CCP information is available on its website [www.meff.com](http://www.meff.com). The information and the documents can either be saved or be printed out.*

**Question 3.** Has the CCP completed and disclosed the answers to the key questions set out in this report? Are there regular reviews to ensure that the information contained in the disclosures remains current, complete and accurate?

*The CCP has completed the answers to the key questions set out in this report and disclosed the answers on its website.*

*Regular reviews are performed to ensure that the contained information is updated, complete and accurate.*

## **Recommendation 15: Regulation and oversight – Not Applicable**

**A CCP should be subject to transparent and effective regulation and oversight. In both a domestic and an international context, central banks and securities regulators should cooperate with each other and with other relevant authorities.**