

# CENTRAL COUNTERPARTY GUARANTEE SYSTEM FOR THE REPO X-COM SECTION

## SERVICE MODEL

Versione 4.9.2

March 26<sup>th</sup>, 2018



**London**  
Stock Exchange Group



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## 1.0 GENERAL FEATURES

### 1.1 Subject of the Service

This document describes the Central Counterparty service offered by CC&G for Repo contracts traded on regulated markets and for collateral management assisted by the Collateral Management service X-COM. The Central Counterparty service is organised in the following phases:

- Contracts acquisition from the regulated markets
- Transactions routing to X-COM
- Margin Calculation
- Fail management
- Default management
- Reporting service

The service model is detailed in the paragraphs below.

### 1.2 Membership of the Repo X-COM Section

#### 1.2.1 Entities admitted to the Repo X-COM section

Banks and investment firms authorised to provide investment services in Italy and legal entities admitted to trading on Markets using the X-COM system may become Clearing or Non-Clearing Members.

#### 1.2.2 Supervisory capital requirements for banks and investment companies

Below are the minimum supervisory capital requirements:

- General Clearing Members: €25,000,000 plus a variable increase depending on the overall number of Non-Clearing Members; €5,000,000 from the second to the fifth Non-Clearing Member inclusive, €10,000,000 up to the tenth Non-Clearing Member inclusive or €15,000,000 after the tenth Non-Clearing Member.
- Individual Clearing Members: €10,000,000

#### 1.2.3 Capital requirements for the companies

- Individual Clearing Members: €10,000,000

#### 1.2.4 Operating Requirements

#### Clearing Members

- Shall join the X-COM service, without prejudice to other requirements provided for CC&G Clearing membership.
- If Clearing Members intend to use an Agent for settlement of margins, the same Agent shall be appointed for all CC&G Sections of which they are Members.
- Note that X-COM Members may appoint a Settlement Agent only for cash or securities, or both. If appointed for both cash and securities, the Settlement Agent shall be the same entity.

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## Non-Clearing Members

- Non Clearing Member shall sign the “Outline Agreement between Clearing Member and Non-Clearing Member”.

### 1.2.5 Membership model

The table below illustrates the combinations of various CC&G and X-COM membership profiles:

	CC&G Membership	X-COM Membership	Entity entitled to settle transactions in X-COM
1	Individual Clearing Member	Individual Clearing Member	Individual Clearing Member or the appointed Settlement Agent
2	General Clearing Member	General Clearing Member	General Clearing Member or the appointed Settlement Agent
3	Non-Clearing Member	General Clearing Member	General Clearing Member or the appointed Settlement Agent

### 1.2.6 Account structure

The account structure rules defined for the X-COM service apply to the collateral settlement transactions of the General Clearing Members and Individual Clearing Members.

In particular, General Clearing Members shall open Giver and Receiver accounts for registration of Non-Clearing Members' financial instruments. For this purpose, General Clearing Members may opt either to open an omnibus account or multiple Giver and Receiver accounts dedicated to individual Non-Clearing Members.

For Non-Clearing Members' Receiver accounts, General Clearing Members may open accounts with or without the collateral re-use option of securities, according to previous agreements concluded with their respective Non-Clearing Members.

The technical features of each account type are detailed in the table appended to this document (cf. 10.1.).

### 1.2.7 Organisational and Technological Requirements

Clearing Members shall subscribe the ICWS technological infrastructure for the purposes of receiving the CC&G reports; If they are already Members of other Sections, they can use the existing infrastructure in place.

### 1.2.8 Admission to the service

Entities already admitted to CCP services for other Sections shall submit the “Request for Services” or the “Request for Services” if they are not Members of any CC&G section, and the additional documentation requested for membership to the service.

In particular, with reference to the account setups, the Member shall specify, for the Giver account, the operative model and, for the Receiver account, the re-use option.

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## 2.0 ACQUISITION OF CONTRACTS FROM THE MARKET AND ROUTING TO THE X-COM SERVICE

Repo contracts concluded on the market are directly sent to CC&G, which acts as a Central Counterparty from the time of their execution.

Upon receipt of the contract, CC&G records it in its own system and subsequently sends the two contracts to X-COM, already matched, including data related to the “front” and “term” legs.

These contracts concern transfer orders between CC&G and the Clearing Member. Transfer orders between a General Clearing Member and a Non-Clearing Member will not be routed to the X-COM System.

On receipt of the two contracts, the X-COM System will validate, enrich and create four Collateral Requests (two for each contract) and four Collateral Instructions (two for the “front” leg, two for the “term” leg) according to the procedures provided by the X-COM service.

Once the aforementioned activities have been completed, X-COM will send a confirmation message to CC&G indicating the Collateral Requests and Collateral Instructions generated, as well as the original contract reference.

For reconciliation purposes, CC&G will calculate its own settlement balances to verify them against those on X-COM in the provisional settlement reports.

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## 3.0 CANCELLATION

Any cancellation of trades required by Market Supervision Depts is sent from Central Counterparty to Monte Titoli, as the X-COM Service Manager. From an operational standpoint, CC&G will make the cancellations in its own system informing its own participants according to the procedures and forward the cancellation request to Monte Titoli to make the appropriate adjustments (cancellations) to the relative Collateral Requests and Collateral Instructions in the X-COM system.

CC&G will notify the market of the cancelled trades, if this information is required by the latter.

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## 4.0 CLEARING AND SETTLEMENT OF GUARANTEED TRANSACTIONS

The clearing and settlement processes provided by the X-COM system for DVP transactions also apply to transactions guaranteed by CC&G. Please note that there is a link between settlement of the Collateral Instructions (“front” and “term” leg) with reference to the same market contract for fail management purposes (cf. 4.2).

### 4.1 Partial settlement

CC&G allows the partial settlement of the guaranteed transaction due to a lack of securities to be transferred as collateral, and only for “front” leg, potentially based on minimum thresholds defined by CC&G. Partial settlement is not allowed due to lack of cash.

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## 4.2 Fail management

Collateral Instructions for guaranteed transactions which are not settled (in whole or partially) upon completion of the clearing and settlement processes on the ISD (Intended Settlement Date) are considered as fail and, only in case of lack of collateral, they are re-proposed during the clearing process of next days till the end of validity date (FV), as following described into 4.2.1 and 4.2.2.

### 4.2.1 “Front” leg

**4.2.1.1** In the event of a settlement failure of the “front” leg Collateral Instruction, due to a total lack of securities upon completion of the clearing and settlement processes on the ISD, the instructions are in fail and are automatically re-cycled to the procedure till the “end of validity date” (FV), ISD + 5 open market days following the ISD or the day before the ISD of the “Term Leg” if this date is before ISD+5.

Upon reaching the FV date and in case of total failure of the settlement, CC&G will offset the “Front leg” Collateral Instruction with the “Term leg” Collateral Instruction both for the Collateral Giver and Receiver. The compensation will imply the exclusion from the X-COM system of both operations that will be carried out by the X-COM service manager, upon request of CC&G. At the same time as the Collateral Instruction is offset, CC&G calculates the cash amount<sup>1</sup> to be paid to the Collateral Receiver. The credit/debit of said amount is performed by CC&G as part of the Daily Settlement procedure on the next CC&G business day.

**4.2.1.2** In the event of settlement failure of “front” leg Collateral Instruction for lack of cash securities, CC&G will offset the “Front leg” Collateral Instruction with the “Term leg” Collateral Instruction both for the Collateral Giver and Receiver. The compensation will imply the exclusion from the X-COM system of both operations that will be carried out by the X-COM service manager, upon request of CC&G, at the end of the day. At the same time as the Collateral Instruction is offset, CC&G calculates the cash amount<sup>2</sup> to be paid to the Collateral Receiver. The credit/debit of said amount is performed by CC&G as part of the Daily Settlement procedure on the next CC&G business day.

**4.2.1.3** In the event of a settlement failure of the “front” leg Collateral Instruction, due to a partial lack of securities upon completion of the clearing and settlement processes X-COM automatically re-cycle the Collateral Instruction in the Settlement System for the unsettled amount until the “end of validity date” (FV), ISD + 5 open market days following the ISD. Upon reaching the FV date (ISD+5) and in case of still partial failure of the settlement, CC&G will offset the “Front leg” Collateral Instruction with the “Term leg” Collateral Instruction both for the Collateral Giver and Receiver for the remaining unsettled amount. The compensation will imply the exclusion from the X-COM system of both unsettled operations that will be carried out by the X-COM service manager, upon request of CC&G. At the same time as the Collateral Instruction is offset, CC&G calculates the cash amount to be paid to the Collateral Receiver. The credit/debit of said amount is performed by CC&G as part of the Daily Settlement procedure on the next CC&G business day.

### 4.2.2 “Term” leg

**4.2.2.1** In the event of settlement failure of the “term” leg Collateral Instruction, due to a total lack of securities, upon completion of the clearing and settlement processes on the ISD, the Collateral Instructions will be marked as fail and they will be automatically recycled in the clearing and settlement processes in the following days, until the “end of validity date” (FV), ISD + 5 open market days after ISD. On ISD+2, CC&G will notify activation of the Buy-in Procedure to the collateral Receiver.

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<sup>1</sup> The cash amount to be paid to the Receiver is determined according to the Annexes to Instruction (Annex B.711bis).

<sup>2</sup> The cash amount to be paid to the Receiver is determined according to the Annexes to Instruction (Annex B.711bis).

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At end of validity date, the “term” leg Collateral Instruction in fail will be excluded from the X-COM System by the Service Manager at CC&G’s request and CC&G will execute the “Buy-In” procedure, appointing a Buy-In Agent to purchase (from FV+1 up to FV+3), at the expense of the Collateral Receiver, the securities the latter failed to re-deliver. The difference between the countervalue of the securities purchased by the Buy-In Agent and the cash to be refunded for the failed transaction will be debited by CC&G to the Collateral Receiver (in malis) during the Daily Settlement procedure on the next CC&G business day following the purchase of the securities by the Buy-In Agent. CC&G will receive securities from the Buy-In Agent and deliver them to the Giver (in bonis) on the same date by means of settlement instruction through Target II. If the Buy-In Agent fails to purchase the securities, CC&G will perform the Cash Settlement procedure

The Cash Settlement will be calculated taking into consideration a percentage of the of undelivered securities counter value. This amount will be debited to the Collateral Receiver (in malis) for the benefit of the Collateral Giver (in bonis), and processed by CC&G during the Daily Settlement Procedure on the next CC&G business day following the Buy-In Agent's failure to purchase the securities (FV+4). Following execution of the Buy-In, CC&G will request the Service Manager to amend the original owner of the securities from the Giver to the Receiver.

**4.2.2.2** In the event of a settlement failure of “term” leg Collateral Instruction due to a failure to return the cash back, the transactions will be excluded from the X-COM System by the Service Manager upon the CC&G’s request. CC&G will immediately activate, through a Sell-out Agent, the “Sell-out” procedure of the securities delivered by the Giver but still on the Receiver's RCA account due to a failure to return the cash back.

If the securities countervalue sold by the Sell-out Agent is less than the original failed transaction countervalue, CC&G will debit the difference to the Collateral Giver during the Daily Settlement Procedure, on the next CC&G business day following the sale of the securities by the Sell-out Agent. The term operation will be settled with the Collateral Receiver through a DVP in Target II.

To this end, CC&G, following the execution of Sell-Out, will require the Service Manager to make the necessary changes so that the securities, received back from Bank of Italy at the end of the re-use period, recorded on the RCA account are considered property and therefore charged to the Giver account.

If the Sell-out Agent fails to sell the securities, CC&G will debit the collateral Giver with the original securities counter value, at term, to cover the losses. Payment will be made during the daily Settlement Procedure on the CC&G business day following the day when the Sell-out Agent failed to sell the securities. Subsequently CC&G will deliver the securities to the Collateral Giver in fail.

In the event of a settlement failure of the “term” leg Collateral Instruction, due to a partial lack of securities upon completion of the clearing and settlement processes X-COM automatically re-cycle the Collateral Instruction in the Settlement System for the remaining unsettled amount until the “end of validity date” (FV), ISD + 5 open market days following the ISD. The fail management referred to in paragraph 4.2.2.1 shall apply to the Collateral Instruction re-cycled by X-COM for the remaining unsettled amount.

## 4.3 Corporate actions management

CC&G will take the option of X-COM automatic substitution. The option Targeted by CC&G takes precedence over the substitution options set by the Collateral Giver.



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## 5.0 RISK MANAGEMENT

### 5.1 Eligible financial instruments

CC&G act as Central Counterparty and clear the contracts related to the following financial instruments:

- government bonds (*sovereign* debt securities) or by supranational organisations (*supranational* debt securities)
- *industry&bank* bonds (*corporate* securities) and local authority bonds (*regional* and *municipal*), including *covered bonds*, *private placements* and government-backed bonds
- securitization debt securities (*mortgage*, i.e. CMO, ABS, CMBS)

matching the following requirements:

- Eligible for collateralization with the European Central Bank;
- Eligible for the centralization in the Central Securities Depository System in Monte Titoli;
- Inclusion in the Eligible Countries, listed in the Annex B.512 to the *Instructions* ;
- Market price or BVAL Model Price;
- *Quotation age*<sup>3</sup> of price up to a maximum of 5 days;
- Minimum risk indicator<sup>4</sup> equivalent to Investment Grade;
- *Close link*<sup>5</sup>;

excluding:

- Infungible, perpetual, and *extendible* securities and *certificates*.

### 5.2 Basket definition

Within the financial instruments accepted by CC&G the baskets of securities traded and managed on the X-COM platform will be defined with the markets agreement.

### 5.3 Management of securities no longer eligible

In case a security already transferred as collateral to the Receiver no longer meets the minimum eligibility requirements, on the start of the next business day X-COM will advise the loss of eligibility and return the ineligible security with simultaneous substitution with an eligible collateral.

Total or partial returns are processed within the availability of alternative eligible securities held on the collateral Giver's account having the CC&G eligibility criteria related to the original transaction basket.

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<sup>3</sup>Maximum quotation age shall mean the maximum difference between the quotation date of the price and the actual date when the price is applied.

<sup>4</sup>For government instruments reference is made to the average rating of the Issuing Country, for financial instruments issued by Supranational Organisations reference is made to the Issuer's average rating, whereas for corporate and mortgage instruments, reference is made to the average rating of the individual instrument (where available). Whereas the Issue rating is not available, the issuer rating will be used.

<sup>5</sup>Securities for which no close link information will be excluded from the CC&G basket.

The restriction applies to debt securities issued by corporate firms and to debt securities deriving from securitization, but it does not apply to government securities, securities issued by supranational organisations or by agencies.

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If the collateral to be returned has been transferred from the Receiver's account to the Bank of Italy Pooling account according to the re-use mechanism, the return of the security to the Giver's account is subject to the Bank of Italy approval. In this case, if the security is ineligible due to:

a) loss of requirements for collateralization with the ECB, then X-COM will execute in sequence:

- a collateral return from the Bank of Italy to the Receiver (without contextual substitution) according to the procedure already in place for X-COM Phase 1;
- a collateral return to the Giver with contextual substitution with securities, available on the Giver's account, having CC&G's eligibility requirements.

b) loss of other eligibility requirements, then X-COM will execute:

- a collateral return to the Giver with contextual collateral substitution;

In this case, the collateral return to the Giver is subject to the availability on the Receiver's account of alternative securities eligible for Bank of Italy and simultaneous availability on the Giver's account of alternative securities meeting CC&G's eligibility requirements.

## 5.4 Financial instruments valuation provided as collateral

In order to ensure alignment of securities positions to current market values, the X-COM system will carry out on a daily basis intra-day and end-of-day evaluation of financial instruments already provided as collateral (Mark-to-Market process) applying an haircut defined by CC&G.

In case of a loss of value in the securities positions, the X-COM system will automatically process guarantee collateral integration (with financial instruments having CC&G's eligibility criteria) from the Giver's account.

In case the Giver is unable to provide swiftly the additional securities, CC&G will require the Giver a Mark-to-market Margin to top up the residual exposure..

CC&G will then debit the cash to the Giver in Target II. This cash amount will be return to the Giver once the additional securities are provided in X-COM.

On the contrary, in case of excess value of the securities positions, the X-COM system will release the collateral for the exceeding countervalue.

## 5.5 Margin methodology

The margin methodology consists of the following margin components:

- a) **Initial Margins (IM)** aims at covering the theoretical costs of liquidation, which CC&G would incur by liquidating the positions hypothesizing the most reasonably unfavourable market scenario. The Initial Margin amount is obtained from the haircut associated with the single security/securities provided as collateral, as indicated by the CCP and managed by the CSD. Increased Initial Margins will apply in case of unsettled forward leg due to lack of securities.

On the "front" leg settlement the Collateral Receiver A (liquidity provider) delivers the cash equivalent to X to the Collateral Giver B who, in turn, delivers to the Receiver A collateral equivalent to X + H (where H is the haircut = IM). CC&G interposes itself between the two counterparties in order to receive and deliver the collateral X + H received from the Collateral Giver B to the Collateral Receiver A. In order to ensure a correct risk management of the guarantees, the Collateral Receiver A shall deliver as collateral an amount equivalent to 2H.

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## IM example:

A DVP trade has been stipulated on the market for € 100 and the haircut applied to the collateral in the contract is equivalent to 5%.

The Collateral Giver, in return for € 100 cash received in the “front” leg, delivers to the Collateral Receiver (through CC&G) collateral equivalent to € 100 plus € 5 for the haircut (the haircut value is calculated by X-COM on the basis of percentages provided by CC&G).

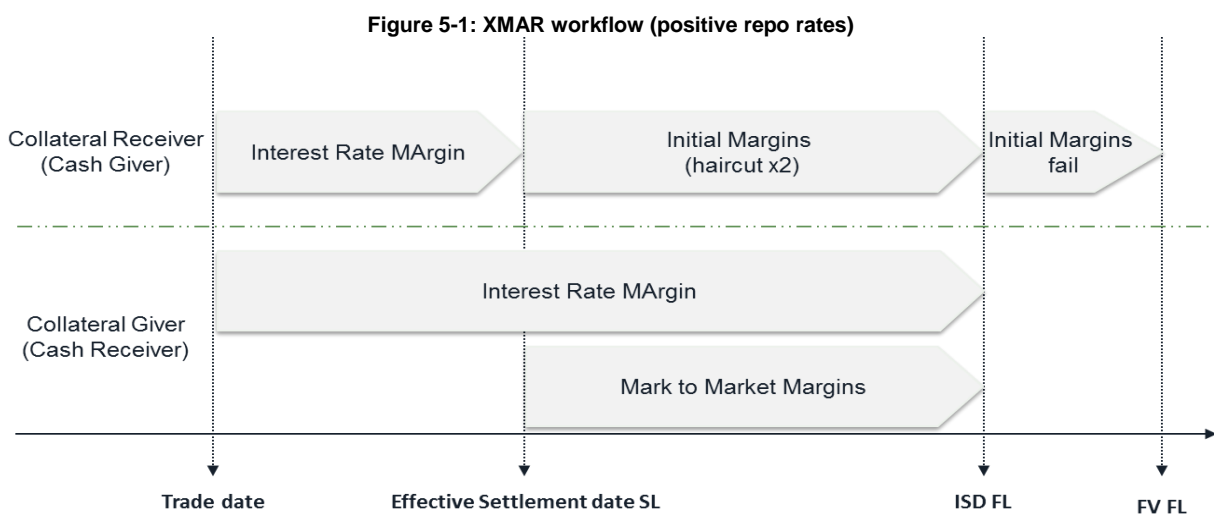
The Collateral Receiver shall, in turn, provide CC&G with the guarantee equivalent to € 5 for his position plus € 5 received from the Giver. The total amount of € 10 (equivalent to twice the haircut) is then paid by the Collateral Receiver to CC&G as the Initial Margin (for this purpose, either cash and/or as securities are accepted by CC&G to cover the Initial Margins as per its standard rules). The guarantee provided by the Receiver will thus be collected by CC&G outside of the X-COM system or by debiting in Target2 or by securities transfer in Monte Titoli.

**b) Interest Rate MArgins (IRMA)**, which are intended to cover (a) the penalties charged by CC&G to the counterparty which fails to pay cash or deliver securities at the intended settlement date of the spot leg and (b) the payment of repo interest at the intended settlement date of the forward leg. Two scenarios are covered:

- CC&G must replace one of the two parties at the end of the spot ISD due to non-delivery of securities or cash, and;
- CC&G must replace the Collateral Giver (Receiver) in case of positive rates (negative) for failure to pay interest at the end of the term ISD.

**c) Mark to Market Margins**, aimed at covering any possible lack of securities by the Collateral Giver in the X-COM Mark-to-Market process. CC&G reserves the right, under any intra-day margin calls, to request these margins solely in cash.

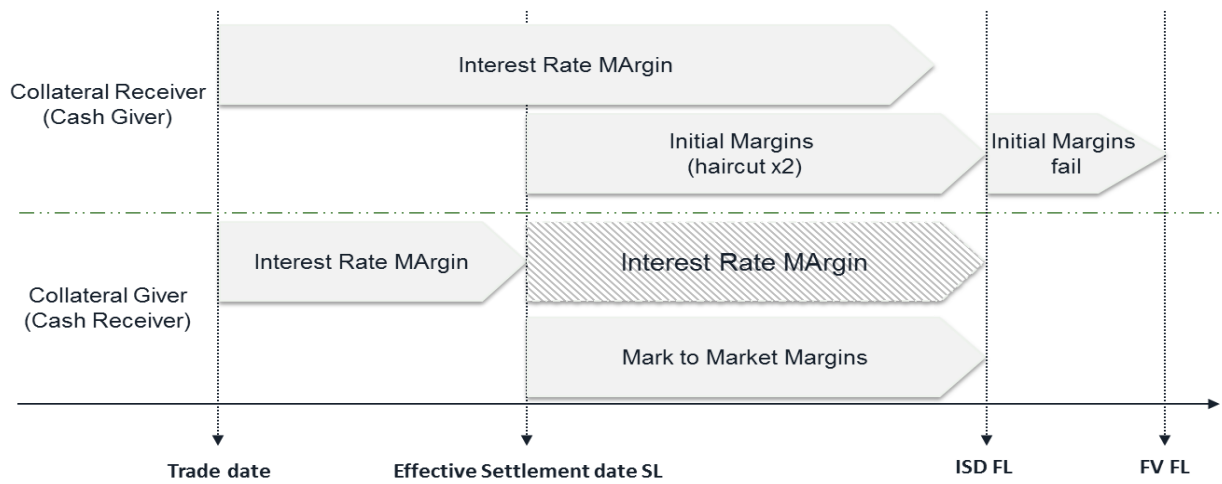
The overall margin scheme is represented below, separately for a scenario with positive repo rates and negative ones:



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Figure 5-2: XMAR workflow (negative repo rates)



For further information please refer to the [X\\_MAR Manual](#).

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## 5.6 Haircut calculation

Haircut are determined based on the volatility associated to each instrument type, Risk Indicator and duration class/residual maturity class.

The updated grid of haircut in force is available on [CC&G's website](#).

## 5.7 Concentration limits

Concentration limits for each Guaranteed Basket are listed on [CC&G's website](#).

## 5.8 Collateral eligible as Margin

The Collateral eligible to cover the Total Initial Margin and the Mark-to-Market margins calculated by CC&G are Euros and Government bonds Euro denominated traded on the Euro MTS and issued by those European Countries with a low credit and market risk level. The additional intra-day margins required by CC&G shall be exclusively deposited in Euro. Cash and security deposits and withdrawals will be processed according to the current CC&G procedures described in the Annexes to the Instructions.

The daily cash calls in Euro will be settled by direct debit of the Member's PM accounts in Target2.

## 5.9 Re-use of collateral

CC&G offers the option for Clearing Member acting as a collateral Receiver to exercise the re-use option for the purposes of collateral transactions with the Bank of Italy Collateral Pooling Management System.

If the collateral Receiver is a General Clearing Member, operating on behalf of its own Non-Clearing Members, the re-use option will be exercised by the General Clearing Member, where provided in the agreements between the General and Non-Clearing Member.

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## 6.0 DEFAULT FUND

A single Default Fund is envisaged for the Repo X-COM section guaranteed markets and Bond Section guaranteed markets. This approach is the same as the one already followed for the guaranteed markets on the Share and Equity Derivatives sections.

The contributions to the Default Fund are due both by the collateral Receiver and by the

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Collateral Receiver in the spot transaction. The contributions are calculated on the basis of the countervalues of the haircuts applied to the used collateral (Initial Margins), as well as in proportion to the IRMA margins.

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## 7.0 REPORTING SERVICE

Information on the X-COM guaranteed transactions are included in the reporting services and data files.

The Technical Manual on the CC&G website contains a detailed description of data report and flows.

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## 8.0 DEFAULT

Within its default procedures, CC&G has implemented all activities aimed at the prompt closing of transactions outstanding in the X-COM system.

In particular, these procedures include the request to X-COM to remove the pending settlement transactions from the system and the open positions closing with the counterparties of the defaulting Member, by trades placed by CC&G.



## 9.0 APPENDICES

### Securities' accounts structure

The account structure for the settlement of traded securities requires to open Source accounts from which the collateral will be taken (Collateral Giver) and to open RCA accounts to which the collateral will be transferred (Collateral Receiver). See below the table with the different accounts structure available depending on the membership profile:

Membership profile	Source Account	RCA Account
<p><b>Individual Clearing Member</b> or <b>General Clearing Member</b> for own activities</p> <p>If the Member makes use of a Settlement Agent, the accounts will be in the latter's name and dedicated to the Member.</p> <p>The Settlement Agent must be the same as the one appointed for Target II, if the Member wishes to benefit from interaction between X-COM and Target II.</p>	<p>Source Account (two options):</p> <ul style="list-style-type: none"> <li>- <b>Standard</b> custody account;</li> <li>- X-COM <b>dedicated</b> GCA Account</li> </ul> <p>If the interaction between X-COM and Target II is required, the ordinary Source Account must coincide with the account used in Target II.</p>	<p>RCA account (guaranteed and non-guaranteed activities) <b>with or without re-use option</b>,</p> <p style="text-align: center;">Or</p> <p>RCA account (for the guaranteed activities only) <b>with or without re-use option</b>;</p>
<p><b>General Clearing Member</b> for activities of its own Non-Clearing Members through use of <b>omnibus</b> accounts</p> <p>If the General Clearing Member makes use of a Settlement Agent the accounts will be in the latter's name and dedicated to of the General Clearing Member for groups of Non-Clearing Members</p>	<p><b>Omnibus</b> Source Account for each group of Non-Clearing Members (two choices):</p> <ul style="list-style-type: none"> <li>- <b>Standard</b> custody account;</li> <li>- X-COM <b>dedicated</b> GCA Account</li> </ul>	<p><b>Omnibus</b> RCA Account for the group of Non-Clearing Members <b>with re-use option</b>;</p> <p><i>The General Clearing Member needs to open a correspondent omnibus Source Account for the group of Non-Clearing Members related to the RCA account with re-use option (*)</i></p>
		<p><b>Omnibus</b> RCA Account for group of Non-Clearing Members <b>without re-use option</b></p>
<p><b>General Clearing Member</b> for Non-Clearing Members own activities through use of <b>dedicated</b> accounts</p> <p>If the General Clearing Member makes use of a Settlement Agent, the accounts will be in the latter's name, dedicated to the General Clearing Member for each individual Non-Clearing Member.</p> <p>The Settlement Agent must be the same as the one appointed for Target II, if the Member wishes to benefit from interaction between X-COM and Target II.</p>	<p>Source Account <b>dedicated</b> to the Non-Clearing Member (two choices).</p> <ul style="list-style-type: none"> <li>- <b>Standard</b> custody account;</li> <li>- X-COM <b>dedicated</b> GCA Account</li> </ul> <p>If the interaction is required between X-COM and Target II, the ordinary Source Account must coincide with the account used in Target II.</p>	<p>RCA Account <b>dedicated</b> to the Non-Clearing Member <b>with re-use option</b>;</p> <p><i>The General Clearing Member needs to open a correspondent Source Account fully dedicated to the Non-Clearing Member related to the RCA account with re-use option (*)</i></p>
		<p>RCA Account <b>dedicated</b> to the Non-Clearing Member <b>without re-use option</b>;</p>

(\*) It's necessary to open the Source Account in order to assist in the "term" leg settlement through the return to the collateral Giver of equivalent collateral available on the Source Account in case the original collateral is then unavailable since re-used in the Bank of Italy Pooling System.

