Own Funds Requirements for Transactions cleared through Eurex Clearing AG

Overview on the exposure calculation and the applicable risk weights under the CRR

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Introduction

The Capital Requirements Regulation (Regulation (EU) No 575/2013 – “CRR”) includes certain privileges as regards the own funds requirements for CCP-cleared transactions

- Exposure values from CCP-cleared transactions can be calculated on a net basis, if covered by an eligible netting agreement (Art 304(1), 305(1) and Art 306(3) in connection with Art 295 et seq. CRR)
- Under further preconditions, reduced risk weights can be applied (i.e. 0%, 2%, 4%)
  - No-recourse clause (Art 306(1)(c) CRR)
  - Bankruptcy remoteness (Art 306(2), 305(2)(a), 305(3) CRR)
  - Segregation (Art 305(2)(a), 305(3) CRR)
  - Porting (Art 305(2)(c) CRR)

When looking at own funds requirements for CCP-cleared transactions, the following exposures need to be distinguished

- Clearing Member’s (“CM”) exposure to CCP / Basic Clearing Member’s (“BCM”) exposure to CCP
- CM’s exposure to its clients
- Client’s exposure to its CM

Eurex Clearing AG (“ECAG”) makes available an English / German law legal opinion which address the exposure calculation and the application of the reduced risk weights in relation to each of its clearing models (“CRR-Opinions”)

- This presentation provides an overview of the own funds requirements of CMs and their clients in relation to transactions cleared through ECAG
Options to apply reduced risk weights for ECAG-cleared transactions (1/4)

- ECAG holds a licence pursuant to Art 14 European Market Infrastructure Regulation (Regulation (EU) 648/2012 – “EMIR”) and thus qualifies as a “Qualifying CCP” (Art 4 (88) CRR)

- According to Art 304(1) CRR (exposure CM -> Clients) and Art 305(1) CRR (exposure Client -> CM) and Art 306(3) CRR (exposure CM -> CCP), the own funds requirements for CCP-cleared transactions shall be calculated pursuant to Sections 1 to 8 of Part 3 Title II Chapter 6 CRR
  - This reference includes the provisions under Art 295 to 298 CRR which provide for the recognition of contractual netting arrangements leading to the calculation of the exposure value on a net basis
  - Close-out netting arrangements under the Clearing Conditions comply with the requirements stipulated by Art 296, 297 CRR and qualify as eligible netting arrangements
  - ECAG’s close-out netting arrangements also include any title transfer collateral
    - the collateral provider’s exposure for the return of collateral provided by way of full title transfer (covering both: Margin and Variation Margin) will be treated as individual transaction within the meaning of Art 296(1)(a) CRR
    - consequently, any “Redelivery Claim” established under ECAG’s Clearing Conditions forms part of the Difference Claim
    - the general risk weight for exposure arising from the Difference Claim is 2% (Art 306(1)(a) CRR)
Options to apply reduced risk weights for ECAG-cleared transactions (2/4)

- Since ECAG is a Qualifying CCP, the general **risk weight for the CM`s trade exposure to ECAG is 2%** (Art 306(1)(a) CRR)
  - the trade exposure is calculated on a net basis
  - also considering any title transfer collateral delivered by the CM
- Art 306(2) CRR provides the possibility to apply a **0% risk weight** to the exposure arising from the collateral provided to ECAG by the CM
  - as title transfer collateral is considered in the close-out netting arrangements, such option only applies to collateral provided by pledge
  - Securities collateral can be provided by pledge under:
    - the Elementary Clearing Model Provisions,
    - the Individual Segregated Account Provisions, and
    - the Basic Clearing Member Provisions
- Art 306(1)(c) CRR allows the application of a **0% risk weight** in relation to exposures arising from client transactions provided that the CM is not obliged to reimburse its client in case of ECAG`s default
- According to Art 304(1) CRR in connection with Art 295 *et seq.* CRR, CM`s exposure to client could be calculated on a net basis
  - Clearing Conditions do not provide for close-out netting provisions in case of a client default
  - CM and client are free to agree on such clauses in their client clearing documentations
- Art 304 CRR does not provide for any reduced risk weights for CCP-cleared transactions
Options to apply reduced risk weights for ECAG-cleared transactions (3/4)

I. Individual Segregated Account Provisions

- Risk weight
  - Under the requirements stipulated by Art 305(2) CRR, the client is entitled to calculate its own funds requirements with a risk weight of 2% (Art 306(1)(a) CRR).
  - Under the ISA clearing model, the client’s positions and assets are:
    - individually segregated from the positions and assets of the CM and other clients of the CM and
    - bankruptcy remote in case of an insolvency of the CM or of other clients of the CM.
  - ECAG’s Clearing Conditions facilitate the transfer of the client’s positions and collateral to another CM in the event of the CM’s default or insolvency.
  - ECAG provides an English law and German law legal opinion confirming that the client bears no losses on account of the insolvency of CM or of any of the CM’s clients.

- Treatment of client collateral
  - **Cash / securities collateral provided via title transfer**: any exposure arising from cash Margin and Variation Margin and securities collateral provided via title transfer is considered in the netting arrangement.
  - **Securities collateral provided by way of pledge**: pledged securities are not considered in the netting arrangement; pledged securities should generally be eligible for a 0% risk weight (Art 305(2), 306(2) CRR) on the basis that it is bankruptcy remote.

- Client Clearing Documentation:
  - To the extent not prescribed by ECAG, the Clearing Member and the client have to ensure their bilateral arrangements are appropriate with regard to the desired treatment of own funds under CRR.
Options to apply reduced risk weights for ECAG-cleared transactions (4/4)

II. Elementary Clearing Model Provisions (Disclosed Direct Clients – GOSA / AbA)

- **Risk weight:**
  - Under the requirements stipulated by Art 305(3) CRR, a Disclosed Direct Client (under a GOSA-account-setup) is entitled to calculate its own funds requirements with a **risk weight of 4%** (in connection with Art 306(1)(a) CRR)
  - Under the Elementary Clearing Model Provisions and Asset Based Allocation (“AbA”), the positions and assets of a Disclosed Direct Client are
    - gross omnibus segregated from the positions and assets of the CM and other clients of the CM and
    - bankruptcy remote in case of an insolvency of the CM or of its clients (Please note: due to the omnibus character, the Disclosed Direct Client may not necessarily be protected from losses in the case that the Clearing Member and another client of the Clearing Member jointly default)
  - ECAG`s Clearing Conditions facilitate the transfer of the client`s positions and collateral to another CM in the event of the CM`s default or insolvency
  - ECAG provides an English law and German law legal opinion confirming that the client bears no losses on account of the insolvency of CM or of any of the CM`s clients

- **Treatment of client collateral**
  - **Cash collateral:** delivered on a title transfer basis, so that any exposure arising from cash Margin and Variation Margin will be considered in the netting arrangement.
  - **Securities collateral:** provided by way of pledge; pledged securities are not considered in the netting arrangement; securities collateral should generally be eligible for a risk **weight of 4%** (Art 305(3), 306(1) CRR) or – depending on the bilateral arrangements between the Clearing Member and the client – a **0% risk weight** (Art 305(3), 306(2) CRR)

- **Client Clearing Documentation**
  - The Clearing Member and the client have to ensure their bilateral arrangements are appropriate with regard to the desired treatment of own funds under CRR.
General overview on exposure treatment under the CRR

1) Non-CRR eligible client segregation solution

- Client exposure risk weight: min 20% + CVA charge
- CM exposure risk weight: min 20% + CVA charge
- Risk weight: 2%

CM exposures with qualified CCPs will receive 2% risk weight
Non-CRR eligible client segregation solutions will not translate into risk weight reductions

2) CRR provides several options to apply reduced risk weights for segregated clients

- Client exposure to CM:
  - risk weight 2% to 4%
  - 0% risk weight possible for securities collateral
- CM exposure to Client: risk weight min. 20% + CVA charge
- CM exposure to CCP:
  - Risk weight: 2%
  - 0% risk weight possible in case of “no-recourse”
  - 0% risk weight for pledged securities collateral

CRR eligible client segregation solutions will generally translate into risk weight reductions: 2% for individual segregation and 4% for gross omnibus segregation

* CVA = Credit Valuation Adjustment
Summary: Options under the CRR to apply reduced risk weights (1/2)

1. Proprietary trade exposure

- Difference claim exposure: 2% Risk weight
- Collateral exposure
  - a) Pledged collateral: 0% Risk weight
  - b) Title transferred collateral: 2% Risk weight

  - CM’s Difference Claim exposure with ECAG will receive a risk weight of 2%
  - Pledged collateral is bankruptcy remote from ECAG, thus 0% risk weight will apply
  - Title transferred collateral receives a risk weight of 2% as it is considered in Difference Claim exposure

2. Financial intermediary trade exposure

- Difference claim exposure
  - a) Recourse possible: 2% Risk weight
  - b) “No-recourse” clause: 0% Risk weight

  - CM’s Difference Claim exposures with ECAG arising from client-related transactions may receive a 0% risk weight, if a “no-recourse” clause is included in the Client Clearing Documentation (Art. 306(1)(c) CRR)
  - Pledged collateral is bankruptcy remote from ECAG, thus 0% risk weight will apply
  - Title transferred collateral would receive a risk weight of 2%, but is legally treated as a transaction and thus already included in difference claim exposure (not subject to risk weighting if “no-recourse” clause is included in Client Clearing Documentation (Art. 306(1)(c) CRR))
Summary: Options under the CRR to apply reduced risk weights (2/2)

3 ISA¹ trade exposure

- **Difference claim exposure**: 2% Risk weight
  - The client’s Difference Claim exposure to its CM for a trade cleared through ECAG will receive a risk weight of 2% (Art 305(2), Art 306 CRR)
  - Client collateral delivered to ECAG via title transfer (cash or securities) is considered in Difference Claim and would receive a risk weight of 2%
  - Pledged securities collateral is bankruptcy remote from ECAG and subject to bilateral arrangements with CM, either a 2% risk weight or even no capital charge will apply

- **Collateral exposure**
  - **a) Pledged collateral**: 2% (or 0%) Risk weight
  - **b) Title transferred collateral**: 2% Risk weight

4 ECM² trade exposure

- **Difference claim exposure**: 4% Risk weight
  - Under ECM with Asset Based Allocation, the Disclosed Direct Client’s Difference Claim exposure to a CM for a trade cleared through ECAG will receive a risk weight of 4% (Art 305(3), 306 CRR)
  - Cash collateral delivered to ECAG via title transfer is considered in Difference Claim and would receive a risk weight of 4%
  - Pledged securities collateral is bankruptcy remote from ECAG and subject to bilateral arrangements with CM, either a 4% risk weight or even no capital charge will apply

- **Collateral exposure**
  - **a) Pledged collateral**: 4% (or 0%) Risk weight
  - **b) Title transferred collateral**: 4% Risk weight
Eurex Clearing’s CRR-Opinions are more comprehensive than opinions provided by other CCPs

Standard CCP opinions cover:

- validity of choice of law
- enforceability of security interests (deed of charge)
- enforceability of netting and porting

In addition to the above, the Eurex Clearing opinion covers:

- the complete CRR analysis (contractual netting agreement, single net sum, segregation and bankruptcy remoteness, no-recourse, default porting)
- applicable for all clearing models
- in respect of CMs located in the UK or in Germany

Other CCP opinions are for their exclusive benefit only, hence their clients are not able to formally rely on them:

- the Eurex Clearing German and English CRR opinions can expressly be relied upon for regulatory and accounting purposes by our clients.

The Eurex Clearing CRR opinion is extensive and can be found in our member section at:
https://member.eurexclearing.com/irj/portal/login?NavigationTarget=navurl://4cc64750faf1a9f98f4bc14328c0684a
CRR opinion coverage

The CRR opinions cover trade exposures in the following relationships:

• CM/BCM towards ECAG (both proprietary and, in case of CM only, financial intermediary) for all clearing models
  • covers requirements as to contractual netting agreement, single net sum, bankruptcy remoteness, no-recourse
  • German CRR opinion is applicable for all CMs regardless of their own place of incorporation
• Disclosed Direct Clients towards CM for all clearing models
  • covers requirements as to single net sum, segregation and bankruptcy remoteness, default porting
  • applicable CRR opinion is determined by the CM’s jurisdiction regardless of the place of incorporation of the Disclosed Direct Client (e.g. English CRR opinion is applicable for all Disclosed Direct Clients using a UK CM)
• Out of scope
  • trade exposure CM towards Disclosed Direct Client: Clearing Conditions do generally not address any consequences of a default of the Disclosed Direct Client
  • close-out netting between Disclosed Direct Client and CM as well as collateral arrangements between Disclosed Direct Client and CM as this is subject to the client clearing documentation
  • in both regards, Disclosed Direct Clients and CMs need to rely on available industry (or tailored) opinions
Calculation of Own Funds Requirements

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