

EuroCCP Clearing Rule Book consultation

Proposal to change certain provisions – comments requested by 20 May 2020

Introduction

EuroCCP intends to implement amendments to its liquidity risk management framework. The amendments will introduce new tools and measures to address potential liquidity risks with the aim to enhance its liquidity risk management framework and to further improve EuroCCP's resilience.

Liquidity is mainly required for securities settlement. The payment and settlement obligations at EuroCCP stem from its function as cash equity clearing house: shares are bought and sold by clearing participants on a trading platform or OTC, and netted to settle two days later. During the settlement, the actual payment for and delivery of the shares take place. This process requires intraday liquidity. If counterparties, which receive shares against payment, are unable to immediately settle, an overnight liquidity need arises. In certain circumstances these overnight liquidity needs may be large, for example when two of EuroCCP's largest clearing participants have defaulted. EuroCCP will then need to (pre-) fund all the purchases of these two clearing participants.

To reduce the likelihood of disruptions in the settlement process in such circumstances, next to the existing liquid resources (collateral provided by clearing participants, EuroCCP equity capital, secured and unsecured liquidity facilities) additional tools and resources to address liquidity risk will be introduced.

First a settlement prefunding requirement is introduced. It is based on the "polluter pays" model whereby the liability for the increased liquidity needs will be carried by the parties that bring the most liquidity risk. This will apply to OTC trades which are ETRs (Exchange Trade Reports) as traded on the markets operated by Cboe Europe Ltd or Cboe Europe BV. ETRs cleared by EuroCCP are a significant driver of EuroCCP's liquidity needs. It will therefore be called from the two largest Clearing Participants who create the largest liquidity exposures arising from entering into ETR trades as described in the previous paragraph. The settlement prefunding requirement will be called at a predetermined percentage of the total liquid resources available to EuroCCP. The predetermined percentage is set at less than 100% of the calculated liquid resources. It serves as a buffer to ensure EuroCCP has sufficient liquidity to cover for the period between requesting the settlement prefunding requirement and the time at which the funds are provided. Not meeting the settlement prefunding requirement within the required timelines will lead to the rejection of any new ETR trades which would otherwise result in increased liquidity risk. As indicated above, the settlement prefunding requirement will only apply to ETRs. However, rule 2.2 (18) of Regulation Trade Refusal permits EuroCCP to reject other OTC trades where the relevant Clearing Participant has not met the Settlement Prefunding Requirement. Stakeholders will be informed in advance if EuroCCP intends to apply rule 2.2 (18) of Regulation Trade Refusal to OTC Trades other than ETRs.

In parallel with the above, an additional transaction acceptance condition in the Regulation Trade Refusal is introduced, which is intended to limit EuroCCP's exposure to OTC trades which would cause EuroCCP's liquidity needs to exceed its liquid resources. Through the amendments, EuroCCP will be able to reject OTC transactions which would create liquidity risk beyond EuroCCP's established liquidity risk tolerance parameters.

Finally, a new measure is introduced which covers any remaining liquidity shortfall. This 'settlement exposure add-on' will be allocated across selected clearing participants based on their (liquidity) exposure. As with the settlement prefunding requirement, it is based on a polluter pays model whereby the liability of the increased liquidity needs will be carried by the parties that bring the most liquidity risk. The settlement exposure add-on will also be called at a predetermined percentage of the total liquid resources available to EuroCCP. The predetermined percentage is set at a level to create a buffer to ensure that EuroCCP has sufficient liquidity to cover for the period between requesting settlement exposure add-on and the time at which the funds are provided.

In summary:

	SPR	SEA
2CP defaulting scenario	For ETRs only and called from the buying CPs with possible rejection of further ETRs if not payed	
Residual liquidity needs stemming from its liquidity risk stress tests		Mutualised across a selected group of CPs

All changes are subject to regulatory review and approval.

In this document the proposed changes are further discussed and explained as to their intended purpose and effect.

The proposed changes are incorporated in the document *EuroCCP Clearing Rule Book (consultation version 21 April 2020)* which is available on the website of EuroCCP.

The introduction of these new tools and measures also require the amendment of the *Regulation Trade Refusal* and the coming into force of a new *Regulation Liquidity Measures*. A copy with the changes of the Regulation Trade Refusal and a copy of the new Regulation Liquidity Measures are also available on our website.

Time lines

The changes to the Clearing Rule Book are open for consultation pursuant to article 3.7.3 of the Clearing Rule Book. The 30 calendar day consultation period ends on 20 May 2020.

Given that the changes to the Regulation Trade Refusal and the new Regulation Liquidity Measures are part of the overall new framework we welcome any comments on any changes in these regulations as well during the Clearing Rule Book consultation period.

The relevant changes are expected to apply shortly after the closing of the Cboe transaction in the first half of 2020. Clearing Participants will be advised of the outcome of the consultation by newflash following the consultation period.

Proposed changes

In this document we discuss and give background to the proposed changes. Drafting changes, typos or lay-out corrections and changed cross-references are not discussed herein unless stated otherwise.

Clearing Rule Book

Article 1.1 Definitions

Additional definition for Settlement Exposure Add-on has been included for the purposes of consistency and clarity.

Article 10.1.2 Breaches

As with Margin and Contributions, it will be a Breach under the Clearing Rules if the Settlement Exposure Add-on is not provided within the stipulated deadlines.

Article 12 Liquidity measures (new provision)

A new provision has been included that will allow EuroCCP to demand an additional amount in the form of a Settlement Exposure Add-on. When and how this amount is called is determined pursuant to the newly introduced Regulation Liquidity Measures.

Regulation Trade Refusal

Replacement of usage of the definition “Exchange”

Technical drafting update not linked to liquidity

Where relevant, the definition “*Exchange*” has been replaced with a more descriptive phrase “*regulated market, multilateral trading facility or other trading venue within the meaning of the MiFID*”.

This technical amendment is intended as a clarification of the existing requirements and is not introduced as part of the new liquidity framework.

OTC trades executed outside regulated markets or multilateral trading facilities can be submitted for clearing. Clearing participants wishing to do so need to meet higher minimum capital requirements. The current Regulation Trade Refusal could be interpreted as not completely reflecting this as the definition of “*Exchange*” also includes “*Platforms*”. Platforms are systems that are not a regulated market or MTF. By referring to “*Exchange*” in the relevant provisions, it may be perceived that the higher capital requirements actually also do not apply when trading on Platforms as they are considered to be transactions that fall within the scope of transactions that are concluded on an Exchange.

The provision is now aligned with practice: enhanced minimum capital requirements apply when transactions not concluded on a regulated market, multilateral trading facility or other trading venue within the meaning of the MiFID are submitted for clearing.

Article 2.2

In article 2.2 (18) an additional transaction acceptance condition is introduced, which is intended to limit EuroCCP’s exposure to OTC trades which would cause EuroCCP’s liquidity needs to exceed its liquidity resources. Consequently, through this amendment, EuroCCP will be able to enforce its right to reject OTC trades which would create liquidity risk beyond EuroCCP’s established liquidity risk tolerance parameters. However these transactions will be cleared if the Clearing Participant meets the Settlement Prefunding Requirement. The latter is defined in the Regulation Liquidity Measures and is discussed below.

Regulation Liquidity Measures

Introduction and Purpose

These provisions set out what the purpose of the Regulation Liquidity Measures is, how it relates to the Clearing Rule Book and the Regulation Trade Refusal and reflects other measures available for EuroCCP in relation to liquidity management.

Article 1 Definitions

This article sets out the definitions used in the Regulation Liquidity Measures and are included for the purposes of consistency and clarity.

Article 2 Designation of Qualifying Clearing Participants

This article sets out when a Clearing Participant will qualify as a Qualifying Clearing Participant for the purposes of being subject to the Settlement Exposure Add-on requirement. The Clearing Participant needs to be active and should have had a substantial clearing activity in the previous 12 months. At all times, at least five Clearing Participants will be designated as Qualifying Clearing Participant. Designation takes place every month.

Article 3 Settlement Exposure Add-on and the Settlement Prefunding Requirement

The Settlement Exposure Add-on and the Settlement Prefunding Requirement need to be paid in cash or securities as specified by EuroCCP in the Regulation Acceptable Collateral. However, EuroCCP reserves the right to require payment in a specific currency to the extent that it falls within the aforementioned regulation. Cross references are included to the articles which set out how the Settlement Exposure Add-on and the Settlement Prefunding Requirement are calculated, collected and returned. Both the Settlement Exposure Add-on and the Settlement Prefunding Requirement can be called intraday as well as end of day.

For the avoidance of doubt the provision explicitly states that the Settlement Exposure Add-on and Settlement Prefunding Requirement do not form part of the default waterfall. This is to make clear that both tools are separate means to address any (potential) liquidity shortfalls.

The principal purpose of the Settlement Exposure Add-on and/or Settlement Prefunding Requirement is to provide a liquidity resource to assist in the settlement of open positions by EuroCCP. The Settlement Exposure Add-on and/or Settlement Prefunding Requirement received from a Clearing Participant would also be available for set off against any amount(s) owed by that Clearing Participant if it were to be placed in default by EuroCCP.

Article 4 Determination of the Settlement Prefunding Requirement and the Settlement Exposure Add-on**4.1 Settlement Prefunding Requirement**

Only those parties that trade ETR trades on the relevant Cboe markets may be subject to a Settlement Prefunding Requirement. Clearing Participants that do not offer such transactions for clearing will not be subject to the Settlement Prefunding Requirement. EuroCCP will calculate the Cover-2 Liquidity Risk (i.e. the risk of the two biggest Clearing Participants defaulting) on an intraday basis. The Settlement Prefunding Requirement will be called at a predetermined percentage of the total liquid resources available to EuroCCP (the Liquidity Risk Threshold). The predetermined percentage is set at less than 100% of the calculated liquid resources. It serves as a buffer to ensure EuroCCP has sufficient liquidity to cover for the period between requesting the Settlement Prefunding Requirement and the time at which the funds should be provided. The percentage will be reviewed from time to time.

If the Cover-2 Liquidity Risk is larger than the Liquidity Risk Threshold, EuroCCP will issue a call for a Settlement Prefunding Requirement to the relevant Clearing Participant that will be the higher of:

- (i) the positive difference between the Cover-2 Liquidity Risk and the Liquidity Risk Threshold; and
- (ii) EUR 1 million (or its equivalent in any other currency).

The EUR 1 million amount is a minimum transfer amount for administrative efficiency to avoid small amounts having to be frequently paid.

The Settlement Prefunding Requirement will be allocated pro rata to the two Clearing Participants that cause the Cover-2 Liquidity Risk. Not meeting the settlement prefunding requirement within the required timelines will lead to the rejection of any new ETR trades which would otherwise result in increased liquidity risk.

4.2 Settlement Exposure Add-on

Only Qualifying Clearing Participants will be subject to a Settlement Exposure Add-on requirement. EuroCCP will calculate any residual liquidity risk stemming from its liquidity risk stress tests ("Residual Liquidity Risk"), including the Cover-1 Liquidity Risk (i.e. the liquidity risk stemming from the default of the single largest Co-CCP), on an intraday basis and end-of-day basis. The Settlement Exposure Add-on will be called at a predetermined percentage of the total liquid resources available to EuroCCP (i.e. the Liquidity Risk Threshold). The predetermined percentage is set at less than 100% of the calculated liquid resources. It serves as a buffer to ensure EuroCCP has sufficient liquidity to cover for the period between requesting Settlement Exposure Add-on and the time at which the funds are provided. The percentage will be reviewed from time to time.

If the Residual Liquidity Risk is larger than the Liquidity Risk Threshold, EuroCCP will call the Qualifying Clearing Participants a Settlement Exposure Add-on that will be the higher of:

- (i) the positive difference between the Residual Liquidity Risk and the Liquidity Risk Threshold; and
- (ii) EUR 1 million (or its equivalent in any other currency).

The EUR 1 million amount is a minimum transfer amount for administrative efficiency to avoid small amounts having to be frequently paid.

The Settlement Exposure Add-on is allocated pro rata to the Qualifying Clearing Participants. It is determined separately from the Settlement Prefunding Requirement and is determined on an intraday as well as end-of-day basis. The Settlement Exposure Add-on will be subject to the Settlement Exposure Add-on Cap which is the maximum possible total Settlement Exposure Add-on across all Qualifying Clearing Participants. The Settlement Exposure Add-on Cap will be set to the largest Settlement Exposure Add-on plus remaining liquidity shortfall on a Clearing Day observed over the previous 12 months. At introduction the cap will be at EUR 1 billion. Qualifying Clearing Participants will be informed of any changes to the cap.

At the beginning of each month the share of each Qualifying Clearing Participant (Settlement Exposure Add-on Percentage) are calculated taking the last Clearing Day of the previous month as reference. The Settlement Exposure Add-on percentage will be effective as of the calculation date.

Article 5 Process of deposit and withdrawal of collateral for the Settlement Prefunding Requirement and the Settlement Exposure Add-on

This provision sets out some of the operational aspects of depositing and returning any Settlement Prefunding Requirement and Settlement Exposure Add-on amounts. Not meeting the deadlines may mean that ETR transactions will be rejected for clearing or other enforcement action is taken by EuroCCP. Clearing Participants may want to revisit their capabilities to meet funding requests especially late in the day.