

Submission Date

03/05/2023

ESMA_QA_880

Status: Answer Published

Additional Information

Level 1 Regulation

Regulation 648/2012 - OTC derivatives, central counterparties and trade repositories (EMIR) - CCPs

Level 2 Regulation

COMMISSION DELEGATED REGULATION (EU) No 153/2013 Regulatory technical standards on requirements for central counterparties

Topic

EU-CCPs

Additional Legal Reference

Article 42 of EMIR - old CCP question 12 dated 11/02/2014

Subject Matter

Default Fund (old CCP question 12 dated 11/02/2014)

Question

- (a) Articles 42(2), 42(3) and 43(2) of EMIR require each CCP to hold financial resources including a default fund sufficient in size to cover losses arising from the default of the two largest members. However the CCP has the right in a default to transfer the positions of clients with porting arrangements to other clearing members. For the purposes of calculating the size of its default fund(s) and members' contributions, can a CCP exclude those client positions that are held in segregated and portable accounts?
- (b) Article 30 of Commission Delegated Regulation (EU) No 153/2013 requires that "when implementing an internal policy framework for defining the types of extreme but plausible market conditions thatcould expose the CCP to greatest risk, a CCP shall specify (for each market to which a CCP is exposed in a clearing member default scenario) extreme but plausible conditions based at least on... (a) a range of historical scenarios... that would have exposed the CCP to greatest financial risk; and (b) a range of potential future scenarios... drawing on both quantitative and qualitative assessments of potential market conditions".
- 1. Is a CCP required to exactly replicate actual historical events in order to satisfy the requirement to use a range of historical scenarios or can a CCP use only quantitative and qualitative scenarios which are generated based on statistics derived from historical price changes?
- 2. When replicating actual historical events is a CCP required to exactly replicate actual historical price changes in all cleared instruments or can a CCP approximate prices moves based on similar instruments or market indices?

ESMA Answer

11-02-2014

Original language

(a) ESMA has considered the argument for not including certain client positions when calculating the size of the default fund to be that these client positions would not be impacted by the default of the clearing member because they are expected to be ported to another clearing member. However, these client positions might have an effect on the overall position

of the clearing member, i.e. the default of one or more clients could increase the likelihood of default of the clearing member. Excluding these positions from the calculation of the size of the default fund could therefore expose the CCP to uncovered risks and this is contrary to the objectives of EMIR.

Furthermore, it is possible that client positions would not be ported but would be liquidated by the CCP and it is possible that some of the clients of one of the CCP's two largest clearing members would expect to port their positions to the other largest clearing member, which would not be possible where those two largest clearing members default concurrently.

Excluding client positions from the calculation of the size of the default fund could therefore expose the CCP to uncovered risks and is contrary to the objectives of EMIR.

(b.1) A CCP is required to specify extreme but plausible conditions based on a range of historical scenarios and additionally a range of potential future scenarios. The range of potential future scenarios is required to draw on quantitative and qualitative assessments of potential market conditions.

Both sets of scenarios must be developed and applied (historical scenarios and potential future scenarios drawing on quantitative and qualitative assessments). The use of statistics derived from historical price changes alone would not satisfy the requirement to use a range of historical scenarios.

When defining its potential future scenarios a CCP might include the use of statistics derived from historical price changes. However, the CCP would still need to include quantitative and qualitative assessments in the development of its potential future scenarios.

(b.2)A CCP might use similar instruments or market indices as a proxy for actual historical price changes so long as such proxies are carefully documented, validated and ensure that no relevant historical price changes have been excluded