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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 45(4) of EMIR - old CCP question 18 dated 11/02/2014

Subject Matter

Use of margins posted by non-defaulted Clearing Members (old CCP question 18 dated
11/02/2014)

Question

(a) Can a CCP have provisions in their rules under which the CCP can reduce pro-rata the amount of variation margin it is due to pay clearing members with a positive change in their positions in order to cover losses resulting from the default of another clearing member (variation margin haircutting) where:

1. The variation margin reduction is limited to a pre-defined monetary amount (e.g. an assessment of up to EUR XX million per clearing member)?
2. The variation margin reduction is limited to an amount which is relative to the exposure that the clearing member brings to the CCP (e.g. an assessment of up to X times the clearing member's prefunded default fund contribution)?
3. There is no pre-defined monetary or relative limit on the size of the variation margin reduction?

b) Can a CCP have provisions in their rules under which the CCP can use margins posted by a non-defaulting clearing member to cover a liquidity shortfall resulting from the default of a clearing member?

ESMA Answer

11-02-2014

Original language

a) EMIR provides that a CCP shall not use the margins posted by non-defaulting clearing members to cover losses resulting from the default of another clearing member (Article 45(4) of EMIR). However, while variation margin represents an amount of margin for the purpose of Article 39 of EMIR (i.e. it is required to be recorded in the separate records and accounts maintained for individually segregated clients as set out in CCP Question 8(2)(e)), such margin represents a payment flow between the counterparties of the original contract and does not represent margin posted by clearing members for the purpose of Article 45(4) of EMIR. Article 45(4) is therefore not applicable. It is compatible with EMIR for a CCP to reduce the amount of variation margin that it is due to pay clearing members with a positive change in their positions in order to cover losses resulting from the default of another clearing member.

EMIR also provides that the clearing members of a CCP shall have limited exposures toward the CCP (Article 43(3) of EMIR) and that a CCP shall ensure that the closing out of any clearing member's positions does not expose the non-defaulting clearing members to losses that they cannot anticipate or control (Article 48(2) of EMIR). Therefore, it is compatible with EMIR for a CCP to have provisions in its rules under which the CCP can reduce the amount of variation margin that it is due to pay clearing members with a positive change in their positions in order to cover losses resulting from the default of another clearing member and where:

1. the variation margin reduction is limited to a pre-defined monetary amount
2. the variation margin reduction is relative to the exposure that the clearing member brings to the CCP.
3. there is no pre-defined monetary or relative limit on the variation margin reduction.

In the first case, the losses to which non-defaulting clearing members are exposed are pre-defined and such losses can be controlled by the clearing member reducing the exposure that it has to the CCP. In the case of 2 and 3 above, the losses to which non-defaulting clearing members are exposed can be calculated as they are a function of the aggregate positions cleared by those clearing members and such losses can be controlled by the clearing member reducing the aggregate positions that it clears with the CCP.

In the three cases above, the exposures are limited on the basis that they can both be anticipated and controlled.

b) EMIR provides that a CCP shall not use the margins posted by non-defaulting clearing members to cover losses resulting from the default of another clearing member (Article 45(4) of EMIR). However, the reuse of margins posted by a non-defaulting clearing member to cover a liquidity shortfall resulting from the default of a clearing member (e.g. the CCP using financial instruments posted as margins by non-defaulting clearing members as collateral for a repo transaction) is compatible with EMIR insofar as it does not represent the final application of such margins to extinguish the losses resulting from the default of another clearing member. This follows from Article 39(8) of EMIR which provides that a CCP shall have a right of use relating to margins or default fund contributions collected via a security financial collateral arrangement and Article 44(3) of Commission Delegated Regulation (EU)

No 153/2013 which provides that a CCP may re-use financial instruments posted as margins, default fund contributions or contributions to other financial resources where the purpose of the re-use is for managing the default of a clearing member (among other possible uses and subject to other specified limitations). When extinguishing losses resulting from the default of a clearing member a CCP must follow the default waterfall prescribed in Article 45 of EMIR (and elaborated in Chapter IX of Commission Delegated Regulation (EU) No 153/2013). Therefore, if the total pool of assets held by the CCP is not reduced then transforming margins from one form to a more liquid form is compatible with EMIR.