

Impact of Recovery and Resolution tools on Clearing Members

1. Background

On 22 January 2021, the Regulation (EU) 2021/23 (CCP RRR) on a framework for the recovery and resolution of central counterparties (CCP Recovery and Resolution Regulation – CCP RRR) was published in the Official Journal of the European Union. The Regulation entered into force on 11 February 2021. Most of its provisions apply from 12 August 2022¹. The objective of recovery and resolution planning for CCPs is to define measures to be taken in extreme but plausible events of financial distress and ensure the continuity of key critical functions such as clearing, while excluding the use of public resources and preserving financial stability.

According to Art. 9 (23) CCP RRR, Clearing Members (CMs) shall communicate to their clients in a clear and transparent manner if and in what way measures in the CCP's recovery plan and potential resolution measures by the resolution authority may affect them. Against this background, Eurex Clearing provides the following overview of the recovery and resolution tools that may impact CMs in order to enable them to fulfil their requirement under Art. 9 (23) CCP RRR. Eurex Clearing only has a principal-to-principal relationship with the CMs and does not intervene in the CMs' relationship with their clients. The impact of any recovery or resolution action on the CMs' clients will therefore depend on the arrangements set out in the bilateral contracts between the CM and its clients.

2. Recovery Options

Eurex Clearing's recovery options consider its nature, size of business as well as its interconnectedness with the financial system and includes capital and liquidity raising options in order to restore Eurex Clearing's soundness. As Eurex Clearing's risk profile is highly influenced by operational risks, the recovery options also include options to mitigate these risks.

Below is an overview of Eurex Clearing's recovery options that may have a direct impact on CMs. The right to use these recovery options in case of a recovery situation is stipulated in the Clearing Conditions.

Recovery Option	Impact for Clearing Members
Realisation of Default Fund Contributions of non-defaulted CMs ²	<p>The usage of the Default Fund Contributions of non-defaulted CMs is integrated in the Lines of Defense to allocate losses resulting from a CM's default. Every CM is required to provide a contribution to the Default Fund in cash amounts and/or securities accepted by Eurex Clearing. Each CM's contribution to the Default Fund depends on the relative risk exposure brought to the Clearing system by such Member.</p> <p>In case of a CM default, Eurex Clearing primarily uses the financial resources (its Margin Collateral) provided by the defaulted CM to cover resulting losses.</p> <p>If the Contributions of the defaulted CM are not sufficient, Eurex Clearing is entitled to realize the Contributions provided by the non-defaulted CMs. First, Eurex Clearing realizes the Contributions from those CMs, which qualified as "a mandatory participant failing to bid or providing an insufficient bid (bad bidders)" in any of the</p>

¹ With the exception of: Article 95 which applies from 4 July 2020; Article 87(2) which applies from 11 February 2021 and Articles 9(1), 9(2), 9(3), 9(4), 9(6), 9(7), 9(9), 9(10), 9(12), 9(13), 9(16), 9(17), 9(18), 9(19), 10(1), 10(2), 10(3), 10(8), 10(9), 10(10), 10(11), 10(12) and 11 which apply from 12 February 2022; Articles 9(14) and 20, which shall apply from 12 February 2023.

² The usage of the Default Fund Contributions of non-defaulted CMs also serves as a recovery option according to Eurex Clearing's Recovery Plan.



	<p>auctions during the Default Management Process (DMP). Second, if the Default Fund Assessments of the “bad bidders” are still not sufficient, Eurex Clearing is also entitled to call all other non-defaulting CMs, which do not qualify as “bad bidders” to provide further contribution.</p> <p>If all pre-funded Contributions to the Default Fund are insufficient, Eurex Clearing is entitled to request the non-defaulting CMs in the Liquidation Group affected to provide so Further Contributions (Assessments - for more information, please refer to the option Assessments below).</p> <p>The Default Fund is segmented into Liquidation Groups, which determines the order in which the funds are drawn. The realisation of Contributions is shared among the relevant Clearing Members on a pro-rata basis.</p> <p>For further information, please refer to Chapter I Part 1 Number 6.2.1 of the Clearing Conditions of Eurex Clearing.</p>
<p>Assessment (Recovery Cash Call)</p>	<p>If, following a default, Eurex Clearing determines that the prefunded Contributions may not be sufficient to cover all losses, Eurex Clearing is entitled to call for Further Contributions (assessments) with respect to the liquidation group(s) in which losses are still not covered. The Assessments may amount up to two times the pre-funded Contributions of the relevant CM.</p> <p>First, Eurex Clearing requests Assessments from those CMs, which qualified as “” in any of the auctions during the DMP.</p> <p>Second, if the Assessments of the “bad bidders” are still not sufficient, Eurex Clearing is also entitled to call all other non-defaulting CMs, which do not qualify as “bad bidders”, for providing Assessments. Assessments from non-defaulting CMs, which do not qualify as “bad bidders”, can only be requested, if Eurex Clearing itself simultaneously provides further own funds to the Default Fund up to an amount of EUR 300.0m (so-called Further Dedicated Amount).</p> <p>The Assessments and the Further Dedicated Amount of Eurex Clearing will only be called and used for the Liquidation Group(s) that the losses derive from on a pro-rata basis.</p> <p>For further information, please refer to Chapter I Part 1 Number 6.3 of the Clearing Conditions of Eurex Clearing.</p>
<p>Request to exchange Securities Margin to Cash Margin (Cash Quota)</p>	<p>This option entails influencing the composition of Eligible Margin Assets already delivered to Eurex Clearing by the CMs to “lock” a sufficiently large portion of cash collateral in order to be able to cover potential liquidity shortfalls at any times.</p> <p>While its first objective is to provide Eurex Clearing with a right to reject a request for the retransfer of cash collateral, the Cash Quota provisions further foresee the right for Eurex Clearing to request the delivery of additional cash collateral in exceptional circumstances (such as unanticipated market developments).</p> <p>For further information, please refer to Chapter I Part 1 Number 3.2.4 of the Clearing Conditions of Eurex Clearing.</p>
<p>Partial Tear-Up</p>	<p>A Partial Tear-Up (PTU) is a mechanism to return to a matched book, which Eurex Clearing can use in the context of the termination of a CM, after standard DMP tools have failed to return the CCP to a matched book.</p>



	<p>(i) The measures Eurex Clearing can apply to restore a matched book differ between (i) Exchange Traded Derivatives (ETD), i.e. Eurex Transactions, and (ii) Over the counter (OTC) Interest Rate Derivative Transactions, due to the different structure of these products. ETDs:</p> <p>For ETDs, Eurex Clearing is entitled to terminate and cash settle open Transactions established between Eurex Clearing and (non-defaulted) CMs which are opposite to the terminated Transactions established between Eurex Clearing and the defaulted CM up to a number and size which is sufficient to cover all of the terminated Transactions of the defaulting CM which could not be replaced by an Independent Trade or Auction. A PTU is distributed between all CMs on a pro rata basis relating to the open interest (number of contracts) in the opposite direction from the terminated contracts, considering all positions across all accounts (house and client). In case rounding is required, Eurex Clearing can use best efforts to find a fair and proportionate distribution of the remaining pro-rata share between the relevant CMs.</p> <p>Contracts will be settled at the auction price in case an auction was partially successful or at the last available settlement price. The most recent of the two will be considered.</p> <p>(ii) OTC Interest Rate Derivative Transactions and OTC Currency:</p> <p>With respect to OTC Interest Rate Derivative Transactions and OTC Currency Transactions, Eurex Clearing assessed that the impact on the affected CM arising from a cash settlement based on the same principles as applied with respect to ETDs is neither transparent nor predictable and entails significant market risk for such CMs. First and foremost, due to the changing structure of OTC transactions driven by post trade events (in particular: compression), it is expected that Eurex Clearing would be required to cash settle a very high number of Transactions to establish a matched book.</p> <p>Therefore, Eurex Clearing will execute a three-stage approach:</p> <ol style="list-style-type: none"> 1) establish additional OTC Hedging Transactions, 2) conduct one additional OTC Auction of the (additionally) hedged portfolio, and 3) if this auction fails again, as a matter of last resort, establish new Transactions between Eurex Clearing and those CMs, which had been invited to the OTC Auction at the last available settlement price. <p>Please refer to 7.5.4.1- 7.5.4.2 of Chapter I Part 1 of the Clearing Conditions of Eurex Clearing.</p>
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3. Resolution Tools

Overall, resolution involves the restructuring of a CCP by a Resolution Authority using resolution tools to achieve one or more statutory resolution objectives. The Resolution Authority may use one or more resolution tools to achieve those objectives.

Resolution action may only be taken by the Resolution Authority where a CCP is failing or likely to fail within the meaning of Art. 22 (1) (a) CCP RRR. In addition, pursuant to Art. 22 (1) (b-c) CCP RRR, the following conditions must also be met for resolution:



- no alternative measures: other private sector or regulatory measures would not prevent the CCP's failure with equal certainty within the available timeframe; and
- public interest: the initiation of resolution action is proportionate and necessary in the public interest to achieve one or more resolution objectives and those objectives would not be achieved to the same extent if the CCP were resolved under normal insolvency proceedings.

When applying resolution tools and exercising the resolution powers, the resolution authority must take into account all of the following resolution objectives in accordance with Art. 21 CCP RRR:

- to ensure the continuity of the CCP's critical functions, in particular:
- to ensure the continuity of the links with other FMIs;
- to avoid a significant adverse effect on the financial system in the Union or in one or more of its Member States; and
- to protect public funds by minimising reliance on extraordinary public financial support and the potential risk of losses for taxpayers.

According to the CCP RRR, Eurex Clearing is required to implement certain resolution tools in its rule books (Clearing Conditions and FCM Regulations) by 12 August 2022. Below is an overview of the resolution options that may have a direct impact on CMs.

Resolution Option	Impact for Clearing Members
Resolution Tear-Up	<p>As of 12 August 2022, the Resolution Authority is entitled to terminate the contracts of the CCP under resolution with the CM in default and/or the contracts of the affected clearing service or asset class (Art. 29 (1) (a) (b) CCP RRR). Tear-ups under resolution are foreseen to function as for recovery as described above.</p> <p>For further information, please refer to Chapter I Part 1 Number 17.7.2 of the Clearing Conditions of Eurex Clearing.</p>
Resolution Cash Call	<p>As of 12 August 2022, the Resolution Authority is entitled to require non-defaulting CMs to provide further contributions to the Default Fund in the form of cash (Resolution Cash Calls) to cover any outstanding Default Loss or Non-Default Loss. The Resolution Cash Calls may amount up to twice the amount equivalent to their contribution to the CCP's Default Fund (Art. 31 CCP RRR).</p> <p>The amount, each CM has to provide, will be determined on a pro-rata basis in proportion to each CM's (pre-funded) Contribution to the Default Fund (Art. 31(1) CCP RRR). The Resolution Authority is entitled to exercise Resolution Cash Calls regardless of whether Eurex Clearing has or has not fully exhausted any calls for further contribution pursuant to Chapter I Part 1 Number 6.3 of the Clearing Conditions.</p> <p>For further information, please refer to Chapter I Part 1 Number 17.7.2 of the Clearing Conditions of Eurex Clearing.</p>
Daily Profits Reduction	<p>As of August 2022, the Resolution Authority is entitled to reduce the daily profits non-defaulting CMs will receive from cleared Transactions which foresee daily Variation Margin or STM Amount payments after the occurrence of a Termination with respect to a CM. The overall amount needed to cover the losses of Eurex Clearing will be</p>



	<p>shared between all CMs on a pro-rata basis. Such reduction right will also be applicable to scenarios in which Eurex Clearing incurred a non-default loss.</p> <p>For further information, please refer to Chapter I Part 1 Number 17.7.2 of the Clearing Conditions of Eurex Clearing.</p>
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