Update on CCP Clearing

SIX x-clear AG

10.09.2019

Topics (10.09.2019)

- EU EMIR 2.2 on Third Country CCP (TC CCP) Supervision, Fees and new Comparable Compliance assessment
- Default Fund Consolidation
- Hard-Brexit risks
- Outlook 2019/20

EU EMIR 2.2

- EU's is expected to pass the amendments to EMIR (European Market Infrastructure Regulation "2.1 & 2.2") in the next quarter 2019, with a 12-18 month detailed implementation time
- With these amendments Third Country CCPs (TC CCP) will face;
  - An ESMA Supervisory College in addition to it's national supervisors
  - Additional fees for this EU supervision (EUR 50k p.a. if Tier 1, or an equal share of ESMA's total budget of EUR 5 – 9 mio p.a. for Tier 2 – i.e. systemically important CCPs) with separate licensing, assessment and exit fees
  - A new EMIR-equivalence and reasoned Comparable Compliance assessment, on a line-be-line basis, by ESMA,
- SIX has answered the related consultations, together with major industry bodies and the US House of Representative and industry peers*
- General TC CCP and TC CCP Policy Maker & Overseer concerns of;
  - Shift of competitive landscape
  - Unclear tiering criteria

* See:
https://www.esma.europa.eu/press-news/consultations/draft-technical-advice-criteria-tiering-under-article-252a-emir22
https://www.esma.europa.eu/press-news/consultations/technical-advice-comparable-compliance-under-article-25a-emir
https://www.esma.europa.eu/press-news/consultations/esma-fees-third-country-ccps-under-emir-22

SIX x-clear Default Fund Consolidation

Background to Default Fund consolidation

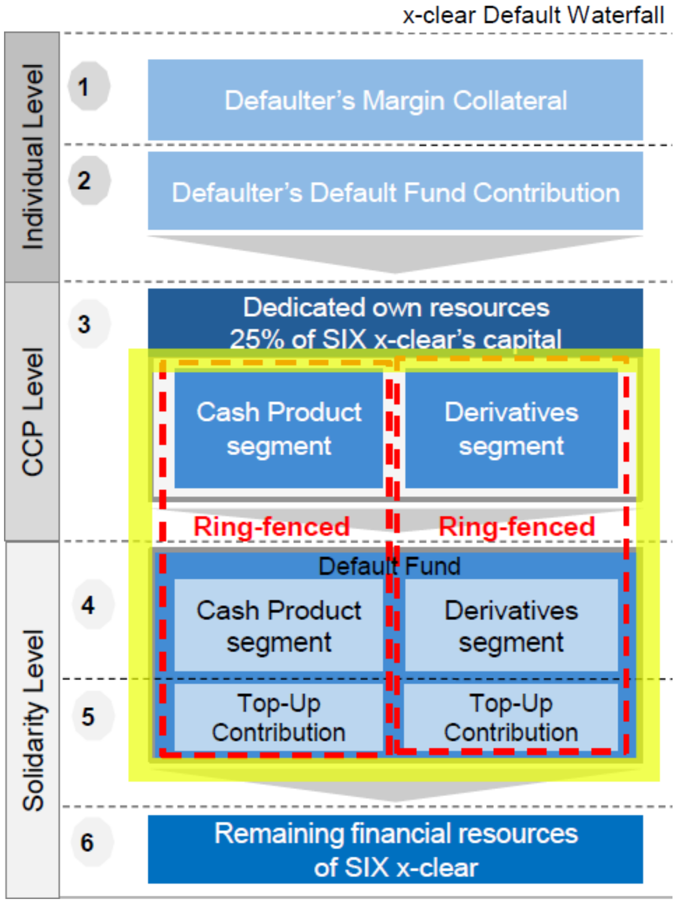
- As a CCP clearer, SIX x-clear assures settlement even in the case where one of the trading parties default
- In order to cover the risks brought by members to the CCP, through their trading, there is a rigorous framework of safeguards, underpinned by state-of-the-art risk models and collateralization
- A key element of this risk management framework is the Default Waterfall, i.e. the collateral resources it has at its disposal in case of any member defaults, and the order of use of those resources
- Since the acquisition of OSLO Clearing in 2015, SIX x-clear operates with two default fund segments
- These two default fund segments will be consolidated into a single default fund without any segments. This will contribute to a diversification of the risks therein and lower member risks and exposures.

Current Default Fund Segmentation

- SIX x-clear operates ;
  - **a Cash Equities segment** ; with 61 Members and CHF 220 mio in Default Fund (DF) base, and
  - **a Derivatives & Cash Segment;** with 12 Members and CHF 44 mio as DF Base
- Each segment has its own Default Fund (DF) with limited capital spill-over in the case of a clearing member default in the other segment
- Member allocation to each segment depends on type of cleared instruments, in case the member is clearing;
  - only Cash instruments (Equities/Bonds)

    → Cash segment
  - Derivatives or a mix of both

    → Derivatives segment



Why change the Setup?

- Merging the default funds will result in an **improved member risk diversification** and **reduce unfavourable margin and risk concentration**
- **The important growth of equities trading** in Nordics in the last few years has led to a **rebalancing** in the Derivatives segment, which is now **dominated by equities exposures** of quite a concentrated group of Clearing Members *
- **Existing equity segment members' are now interested in derivatives clearing** which – under current segmentation rules – would require a shift to the Derivatives segment and require another rebalancing
- Simplifying the structure will bring operational efficiencies and establish a uniform framework ahead of the introduction of the **New Clearing Platform (NCP)**
- F**acilitate business expansion**
- With netting effects the aggregate default fund – all the while still assuring a "Cover 2", i.e. the cover of a potential default of the two largest CMs under stressed but plausible conditions – would be **CHF 220 mio, to be shared among the 73 Clearing Members**

* Equities Derivatives (futures/forwards and options on Oslo Börs Index and 25 single stocks has fallen to less than 3% of total in terms of stress exposure, needing cover (actual observations less than 2%)

Summary and Implementation

- New unified Default Fund CHF 220 mio
- Effective 01.10.2019
- Members will be informed of new Default Fund contribution requirements on the effective date, and has two calendar days to pay in, or are able to withdraw any excess, from the day of notification
- There is no change to the Default Fund requirements calculations
- There is no change to the order, or structure of the Default Waterfall, and the committed Own Funds (“Skin-In-The-Game”)   - now applied to the single default waterfall
- There is no change in the minimum DF Contribution requirements
- Members should inform their accounting and treasuries, so as to correct risk capital and any liquidity set-off calculations (and the applicable rebates thereto)

Residual Brexit Risks

- SIX x-clear has filed for UK recognition (in 2H 2018), and the ESMA recognition from 2016 is not affected
- Without a mutual (new) agreement between UK and EU authorities, and given current status, EU's MiFIR **Share Trade Obligation** (STO – Art 23) will split the ISIN worlds into an EU and a UK one, which will affect;
  - Where the instruments can legally be traded, and
  - cross-nettings and thus Margins for CCPs
- Mutual UK and EU CCP recognitions are assured through "grand-fatherings" until 30,03.2020
- Derivatives contract continuity
- Intra-dealer trading
- Mid-week Brexit
- Market volatility risks

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Outlook

- Continued business expansion in existing segments
- Brexit risks and UK licensing assurance
- Switch to sole clearer of Oslo Börs derivatives (Nov 2019)
- CSDR-compliance (13.09.2020) alongside with SFTR and SRD II
- Updates (4th version) of Recovery & Resolution plans (2Q2020)
- Implementation of New Clearing Platform (2019/2020/21)

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