CONSULTATION ON CHANGES TO THE CLEARING RULES: NON-DEFAULT LOSS ALLOCATION

1 Overview

1.1 CME Clearing Europe (CMECE), as a Recognised Clearing House (RCH), is bound by the Recognition Requirements. Changes have been made to the Recognition Requirements which require RCHs to have loss allocation rules in place for non-default losses. Specifically, a new requirement has been inserted in Part 5 of the Schedule, after paragraph 29 (requirements of the EMIR regulation), which states:

"Loss allocation

29A. The central counterparty must maintain effective arrangements (which may include rules) for ensuring that losses that—

(a) arise otherwise than as a result of clearing member default; and

(b) threaten the central counterparty’s solvency;

are allocated with a view to ensuring that the central counterparty can continue to provide the services and carry on the activities specified in its recognition order.

1.2 The Appendix to this Notice details the changes that CMECE is proposing to make to its Clearing Rules¹ in order to fulfil this requirement. Under these proposed rules, CMECE will bear the investment loss up to 100% of its credit risk, counterparty and market risk capital requirement, with further losses attributed on a pro-rata basis. The Clearing Members pro-rata share of a major investment loss will be determined by CMECE acting reasonably.

1.3 We would welcome comments from Clearing Members. Responses should be sent to compliance@cmeclearingeurope.com by 6 May 2014.

2 Further Information

2.1 For further information please contact Anita Collett, Head of Regulatory Compliance, on +44 (0)20 3379 3136 or email: Anita.Collett@cmeclearingeurope.com

¹ The changes have been made against the Clearing Rules to be effective 27th April 2014, as confirmed via Notice 14-24 published 14th April 2014.
APPENDIX

CMECE Rulebook – proposed amends for allocation of investment losses

Investment Loss means any loss or diminution in the value of, or depreciation that has occurred in or in connection with any Collateral, Contributions, Assessments or Optional Payments as a result of any investment of such assets made by the Clearing House or on its behalf (including, without limitation, by an Investment Agent);

Major Investment Loss has the meaning given in Rule 2.3.4(j);

Relevant Capital Requirement means, the amount of capital that the Clearing House is required to hold pursuant to Article 1, paragraph 1(c) of the Commission Delegated Regulation (EU) No 152/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on capital requirements for central counterparties;

2.3.4 […]

(j) any loss or diminution in the value of, or depreciation in or in connection with any, Collateral, Contributions, Assessments or Optional Payments provided to the Clearing House pursuant to the Rules, save where any loss with respect to Collateral is incurred by the Clearing House as a direct result of any investment made by the Investment Agent pursuant to the investment policy of the Clearing House which loss shall be borne by the Clearing House.

(i) including the amount of any Investment Losses arising from one event or (in the reasonable discretion of the Clearing House) a series of connected events which exceeds an amount equal to the Relevant Capital Requirement. Such excess is a Major Investment Loss and shall be borne by the Clearing Members in accordance with Rule 2.3.10; but

(ii) excluding other Investment Losses, which shall be borne by the Clearing House.

2.3.10 A Major Investment Loss shall be borne by all Clearing Members in the following way:

(a) the loss shall be shared by each Clearing Member in the proportion (determined by the Clearing House acting reasonably and based on the blended exchange rate used by the Clearing House in its ordinary course of trading) that:

(i) the amount of cash Collateral, Contributions, Assessments and Optional Payments attributed to that Clearing Member in the books and records of the Clearing House (the Maximum Share); bears to
(ii) the amount of cash Collateral, Contributions, Assessments and Optional Payments attributed to all Clearing Members in the books and records of the Clearing House;

(b) the amount calculated under Rule 2.3.10(a) in respect of a Clearing Member shall be allocated:

(i) pro-rata across all Accounts of that Clearing Member; and

(ii) pro-rata against the Collateral, Contributions, Assessments and Optional Payments connected with each Account of that Clearing Member;

(c) such allocation will reduce the value of such Collateral, Contributions, Assessments and Optional Payments (and the rights of each Clearing Member in respect of them) for all purposes including without limitation:

(i) in relation to the obligation of the Clearing House to return Equivalent Assets under Rule 3.10 or otherwise;

(ii) calculating the rights and obligations of the Clearing House and Clearing Members under Rule 2.4;

(iii) calculating the Net Settlement Amount pursuant to Rule 6.1.5;

(iv) re-assessing a Clearing Member’s Contribution pursuant to Rules 7.2.3 and 7.2.4; and

(v) determining the amount of the Assessment that a Clearing Member owes pursuant to Rule 8.7; and

(d) a Clearing Member shall not bear (under this Rule, Rule 2.3.1 or otherwise) more than its Maximum Share of any Major Investment Loss.

3.10.5 Notwithstanding any other provision of the Rules, no Clearing Member shall have any right, title or interest in any Collateral, Contributions or Optional Payments that have been transferred to the Clearing House or to its Custodian save as otherwise agreed. A Clearing Member will, subject to the provisions of the Rules (in particular, the Default Rules), only have a right to return of Equivalent Assets. If the Clearing House is expressed to have an obligation (pursuant to this Rule 3.10 or otherwise) to transfer to the Clearing Member an amount of cash or an asset in respect of Collateral, Contribution, Assessments or Optional Payments received by the Clearing House, the Clearing House shall only be obliged to transfer an Equivalent Asset to the Clearing Member’s Bank

2 Note: when FS rules are approved, this Rule will also expressly permit “the Clearing House to withdraw the pro-rata value from the relevant FS Account in accordance with the provisions of the relevant FS Documents”
Account or the account for Eligible Securities or the Allocated Precious Metals Account referred to in Rule 4.2.6. Notwithstanding the foregoing, the Clearing House reserves the right to transfer Eligible Cash in respect of Eligible Securities and Eligible Precious Metals if an event occurs which introduces uncertainty, volatility or risk into the financial markets or a part thereof and the Clearing House it is unable, using reasonable endeavours, to locate or obtain Equivalent Securities or Eligible Precious Metals and in any event to value such Eligible Assets as it may reasonably determine in accordance with the Clearing and Settlement Procedure. For these purposes, the Clearing House may not be able to locate or obtain Eligible Assets if the issuer of the Eligible Assets or a Custodian or other securities depositary that was holding them fails or it determines that it is otherwise prohibitively expensive to purchase such Eligible Securities or Eligible Precious Metals or the Clearing House is concerned that the pricing of such Eligible Securities or Eligible Precious Metals is unreliable because the relevant markets are not sufficiently liquid, transparent or are otherwise not functioning properly.

6.3.6 The Clearing House shall have the right to deal with any Eligible Assets and Distributions in any manner including (without limitation) by partially or wholly investing Eligible Cash for its own account pursuant to the investment policy adopted by the Clearing House. Any losses incurred by the Clearing House as a direct result of any investment made by the Investment Agent pursuant to the investment policy of the Clearing House shall be borne by the Clearing House.