

Circular C-IRS-03/2023

Default Fund

BME CLEARING

22 September 2023

Segment: IRS

Effective Date: 29 September 2023

Replaces: C-IRS-02/2023

This Circular establishes the contribution to the Default Fund and the utilisation and replenishment of contributions. The sections relating to the replenishment of the contributions to the Default Fund and their utilisation are modified due to the introduction of Additional Dedicated own resources.

This Circular is published in accordance with the provisions of the Article regarding “Margins required by BME CLEARING” of BME CLEARING’s Rule Book and following the provisions of Articles 39, 42 and 43 of the Regulation (EU) No 648/2012 and Article 30.1 of the Delegated Regulation (EU) No 153/2013.

1. DEFAULT FUND AMOUNT

The amount of the Default Fund for the OTC Interest Rates Contract Group must cover the Risk in the last calendar quarter, under Stress Test conditions, on the basis of the maximum combined daily risk of the two Clearing Members with the largest risks from a same risk scenario, multiplied by an additional factor.

The Factor Parameter applied is available in BME CLEARING website, in the excel file Default fund-IRS.xlsx, that can be found in the following link:

<https://www.bmeclearing.es/ing/Resources/Circulars>

For this purpose, a Clearing Member's Risk under Stress Test conditions is calculated for each day, using the model provided in the Appendix to this Circular.

The Default Fund amount is updated when required, in order to cover the risk mentioned in the first paragraph above, and at least each calendar month. The updated Default Fund amount is published within the two first business days following each update and Members will have to post their contributions with value date the following business day after BME CLEARING’s notice.

In any case, this amount may not be less than EUR 5 million.

2. DEFAULT FUND CONTRIBUTION FROM CLEARING MEMBERS

- 2.1 Independently of the other margins that are established, each Clearing Member is obliged to contribute to the Default Fund of each Contract Group in which the Member takes part as a Clearing Member.

- 2.2 The contribution that each Clearing Member makes to the OTC Interest Rates Contract Group Default Fund consists of a fixed minimum amount, which depends on the Clearing Member's type and on whether the Member manages a Second-tier Register.

The following table shows these amounts:

MEMBER TYPE	Default Fund Minimum Contribution
Clearing Member	€500,000

- 2.3 A Clearing Member's contribution to the OTC Interest Rates Contract Group Default Fund may be higher than the minimum amount shown in 2.2., if the total minimum amounts of all Clearing Members is below the amount that the Default Fund must hold as specified in Section 1 of this Circular.

In order to calculate which Clearing Members must contribute to the Default Fund with a higher amount than the minimum amount, the necessary Default Fund amount as specified in Section 1 will be shared between the different Clearing Members on a proportional basis to each Member's exposure in relation to the total for all Clearing Members in the Clearing House. Exposure is to be understood as the Clearing Member's average of its 5 largest risk amounts in the last natural quarter.

As a result of this distribution calculation, those Members who are assigned an amount which is less than their minimum contribution will be removed from the distribution. For the remaining Members, exposure percentages will be recalculated, and the additional contribution to the Default Fund will be calculated in respect of the minimum amount they need to contribute by multiplying exposure percentage by the difference between the amount that the Default Fund must hold, as stated in Section 1, and the sum of the minimum contributions of all Clearing Members.

The additional contribution shall take effect provided that it is an amount greater than € 50,000, and it shall be in multiples of € 50,000.

Clearing Members required to contribute additional funds, will have to post them with value date the following business day after the funds were requested by BME CLEARING.

- 2.4 The Circular of Posting of Margins of the OTC Interest Rates Contract Group, or the Circular which replaces it, describes the forms in which the Default Fund contributions can be posted and the form in which margins are paid interest, if applicable.
- 2.5 The Margin contributed for this purpose will not be taken into consideration for the purposes of Risk Limits.

3. UTILISATION OF THE DEFAULT FUND AND REPLENISHMENT OF CONTRIBUTIONS

- 3.1 In the event that the Members' Default Fund has to be used, as provided for under Article 45 of the Rule Book, the provisions of the said article will be applied; the amount utilised will be proportionally split according to the Default Fund contribution made by each Clearing Member, as compared to the total Default Fund amount of the corresponding Contract Group prior to the default situation.
- 3.2 Clearing Members must replenish the utilised part of their contribution with value date the following business day after the use of the Default Fund takes place and in an amount at least equal to the amount used for each Clearing Member.
- 3.3 In case a default by a Clearing Member is declared and the Default Fund must be utilized, for a period of 90 consecutive calendar days starting on the day following the day of the Declaration of Default, and in order to cover the losses arising from such Default or any other Default declared thereafter during such period of 90 calendar days from the first Declaration of Default, the maximum aggregate amount that the rest of Clearing Members can be assessed to replenish shall be twice the amount of their contribution prior to the Declaration of the Default.

At the end of the 90-day period, the Clearing Members must contribute to the Default Fund according to the new calculated level and proportions. The Default Fund replenished according to the new calculated level and proportions shall only be used to cover any Default declared after the above mentioned 90 calendar day period.

- 3.4 In the event that the Default Fund is utilised once in more than 50% of its full amount, or more than once within three consecutive months, in addition to its replenishment by Clearing Members, and during a minimum period of three months, Initial Margins will be calculated using the same parameters that are applied to the Stress Test as described in the Appendix to this Circular.

4. REFUND OF THE DEFAULT FUND CONTRIBUTION

If a Clearing Member informs BME CLEARING of its intention to cease its membership, BME CLEARING will refund its Default Fund contribution when the said Member has closed out its open position at BME CLEARING.

If during the period between the notification of ceasing membership and the closing of the full position, as mentioned in the previous paragraph, a Member defaults, the contribution to the Default Fund of the Member which has withdrawn from membership may be used in accordance with the provisions contained in Chapter 9 of the Rule Book. In this case, the Member will not be obliged to replenish its contribution to the Default Fund if the Member closes out all its positions within 5 business days of the request for replenishment.

In the event of the Default Fund being used and a subsequent request for replenishment of contributions being made to each Clearing Member, a Member will not be required to replenish its contribution if it submits a request to cease membership and closes out all its positions within 5 business days of the request for replenishment.

In any case, until the Member has definitively ceased and no longer has any liability or outstanding obligation to BME CLEARING, as stipulated in the Rule Book, BME CLEARING shall block enough funds, to a maximum level equal to the amount of the Member's Default Fund contribution (not any longer as Default Fund contribution), only for the purpose of securing payment of all outstanding debts of the Member.

APPENDIX

CLEARING MEMBER'S RISK CALCULATION UNDER STRESS TEST CONDITIONS

The calculation of the Clearing Members' risk under Stress Test conditions is based on a model that envisages:

- The worst scenarios based on historical data recorded over the last 30 years or as long as there is reliable historical data available and depending on the market conditions at each point.
- Hypothetical scenarios that recreate extreme no historical but plausible fluctuations, according to Article 30 of Delegated Regulation (EU) 153/2013, which develops Article 42 of Regulation (EU) 648/2012.

The shortfall for each open position is calculated for each Stress Test Scenarios according to the scenarios which are published in the Stress Test Calculation Scenarios Circular of the OTC Interest Rates Contract Group or any other that could substitute it.

Historical Stress Test Risk

The risk in a stress test situation of each Margin Account (hereinafter the "Account") is obtained by applying the following formula:

$$\text{Account Risk } i \text{ in scenario } j = \text{Net Present Value in scenario } j - \text{Net Present Value EOD} - \text{Posted Margin}$$

The scenarios applied to the open position registered at the end of the date (EOD), and the losses registered in each scenario (compared to the position's Net Present Value at the end of date) are compared with the Margins posted in the associated Collateral Account.

The Net Present Value in scenario j is adjusted by the ratio between (1) the Base IM plus the Adjustment for position size and (2) the Base IM calculation for each account at the end of date.

If an account shows a positive amount (gain) and the account belongs to a Client, the Account Risk in each scenario will be considered to be zero.

The Clearing Member's Risk in each scenario j is the sum of:

- The Risk of its Proprietary Account in scenario j
- The Risk of its Clients' Accounts in scenario j

The Historical Stress Test of a Clearing Member (CM) will be the worst-case historical scenario.

Hypothetical Stress Test Risk

With the same Account Risk formula and with the same rules explained for Historical Stress Test, the Risk of the Clearing Member for each hypothetical scenario is calculated.

The hypothetical stress test of a Clearing Member would be the worst-case hypothetical scenario.

Clearing Member Stress Test Risk

The Stress Test Risk of a Clearing Member, is the maximum between its worst historical and worst hypothetical scenario increased by the Concentration risk adjustment at a Clearing Member level, only if positive.

The Concentration Risk Adjustment at a Clearing Member level is calculated as the difference between the Adjustment for position size at a Clearing Member level and the sum of Adjustment for position size applied to each Clearing Member's account at the end of date. The obtained value is multiplied by the ratio between (1) the worst stress test scenario (historical or hypothetical) and (2) the sum of IM base of each Clearing Member's account at the end of date.

The Adjustment for Position Size at a Clearing Member level starts by splitting in aggregate form all its accounts' position into receiver fixed side and payer fixed side. For each bucket the maximum between the calculated Adjustment for Position Size for each side is selected. The resulting value is added to the maximum values in the remainder buckets, obtained following the same process. The calculation algorithm is the same as described on the circular Procedure for Initial Margin Calculation.

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