

Circular C-IRS-02/2025

Default Fund

BME CLEARING

23 January 2025

Segment: IRS

Effective Date: 3 March 2025

Replaces: C-IRS-03/2023

The Default Fund, along with its amount, distribution and updating criteria are regulated.

It also regulates the utilization and replenishment of the posted contributions, the additional contributions and their maximum limits in the event of a Default.

The text has been amended to clarify the wording in certain sections.

This Circular is published in accordance with the provisions outlined in the Default Fund section 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 of the Delegated Regulation (EU) No 153/2013.

1. DEFAULT FUND AMOUNT

The amount of the Default Fund for the OTC Interest Rates Segment must cover the Risk in the last calendar quarter, under Stress Test conditions, based on 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, at a minimum, every calendar month within the first 4 business days of the month. Members are required to post their contributions with a value date on the business day following BME CLEARING’s update 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 Segment in which the Member takes part as a Clearing Member.

- 2.2 The contribution that each Clearing Member makes to the OTC Interest Rates Segment Default Fund consists of a fixed minimum amount and, if applicable, an additional variable amount.

The fixed minimum amount depends on the Clearing Member's type.

The following table shows these minimum fixed amounts:

MEMBER TYPE	Minimum fixed amount of the Default Fund Contribution
Clearing Member	€500,000

- 2.3 A Clearing Member's contribution to the OTC Interest Rates Segment Default Fund may exceed the fixed minimum amount specified in section 2.2., if the total fixed minimum contributions from all Clearing Members does not reach the overall minimum amount required for the Default Fund according to section 1 of this Circular.

To determine which Clearing Members must contribute an additional variable amount to the Default Fund in addition to the fixed minimum amount, the total minimum amount of the Default Fund specified in section 1 will be allocated among the different Clearing Members on a proportional basis to each Member's exposure in relation to the total for all Clearing Members in the CCP. Exposure is defined as the median of the 5 largest stressed risk amounts recorded by each Clearing Member in the last natural quarter.

Those Members who are assigned an amount lower than the fixed minimum as a result of the allocation will be excluded from the distribution, and their contribution to the Default Fund will be the fixed minimum amount. For the remaining Members, the exposure percentages will be recalculated, and the additional variable amount to the fixed minimum contribution to the Default Fund will be determined by multiplying their exposure percentage by the difference between the required amount that the Default Fund must hold, as specified in section 1, and the sum of the minimum contributions of all Clearing Members.

The additional variable amount of the contribution to the Default Fund will be required by BME CLEARING whenever it exceeds € 50,000, in multiples of € 50,000, and must be contributed by the Clearing Members with a value date on the following business day.

- 2.4 The Circular of Posting of Margins of the OTC Interest Rates Segment, 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 contribution to the Default Fund will not be considered for Risk Limits purposes.

3. UTILISATION, REPLENISHMENT, ADDITIONAL CONTRIBUTIONS AND LIMITS TO THE DEFAULT FUND

Utilisation for the posted Default Fund

- 3.1 In the event that the Default of a Clearing Member is declared, and the Default Fund has to be used, as provided for under Article 45 of the Rule Book, the provisions of said article shall be applied (execution of the collateral provided as Default Fund), and the amount utilised shall be allocated proportionally according to the Default Fund contribution made by each Clearing Member, as compared to the total Default Fund amount of the corresponding Segment prior to the default situation.
- 3.2 In the event that the Default Fund has to be used for more than 50% of its total amount, or more than once within 90 consecutive calendar days, Initial Margins will be calculated, for a minimum period of three months, with the same parameters that are applied to the Stress Test as described in the Annex to this Circular.

Additional contributions in the event of Default

- 3.3 In accordance with Article 45 of the Rule Book, if, after having disposed the posted Default Fund and the additional specific own resources of BME CLEARING, there are still uncovered losses arising from the Default, BME CLEARING may require the non-Defaulting Clearing Members to make additional contributions to the Default Fund. These contributions must be made on the following business day, and the collateral provided will be subject to immediate execution.

Replenishment of the Default Fund

- 3.4 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.

Limits on contributions to the Default Fund

- 3.5 For a period of 90 consecutive calendar days, starting from the day following the day of the Declaration of Default, and in order to cover losses arising from that Default or any subsequent Defaults declared within such 90 calendar days period, the aggregate amount of replenishments of the Default Fund, as referred to in section 3.4, along with the additional contributions to the Default Fund specified in section 3.3, that may be required from non-defaulting Clearing Members shall not exceed twice their existing contribution to the Default Fund prior to the first Default.

At the end of this 90-day period, Clearing Members must make their contributions to the Default Fund according to the new Default Fund calculated at that time. The

replenished Default Fund according to the new calculated size and proportions, may only be used to cover any Default declared after the above mentioned 90- day period.

4. REFUND OF THE DEFAULT FUND

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 as a Clearing Member 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 who 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 or make the additional contributions required under Article 45 of the Rule Book if it closes out all its positions within 5 business days of the request for replenishment by BME CLEARING.

In any case, until the Member has definitively ceased and has no further liability or outstanding obligation to BME CLEARING, as stipulated in the Rule Book, BME CLEARING shall block funds belonging to the Member, up to an amount equivalent to the Margins posted by the Member, as a condition for the payment of all outstanding debts.

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 Segment 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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