Eurex Clearing Circular 109/18

Launch of refined LSOC service offering; Amendments to the FCM Regulations of Eurex Clearing AG

Summary

This circular contains information with respect to Eurex Clearing AG´s ("Eurex Clearing") LSOC (Legally Segregated Operationally Commingled) service offering.

In February 2016, the U.S. Commodity Futures Trading Commission ("CFTC") granted Eurex Clearing registration as a Derivatives Clearing Organization ("DCO") for the clearing of swap transactions for entities located in the U.S. In this context, Eurex Clearing now launches a refined client-clearing framework which is in compliance with the LSOC requirements stipulated by the CFTC. The relevant FCM Clearing Conditions have been published and announced with Eurex Clearing circular 072/18 on 24 August 2018 and can be found on the website of Eurex Clearing www.eurexclearing.com.

The initial service offering will provide for a file-based model allowing for "LSOC With Excess". The functional roll-out for "LSOC Without Excess" is planned for 2019.

Date: 20 December 2018

Recipients: All Clearing Members and FCM Clearing Members of Eurex Clearing AG

Authorized by:
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Related Eurex Clearing circulars:
072/18; 081/18; 087/18

Target group:
- All departments

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Admission criteria

Legal admission requirements

The LSOC model is offered to applicants that are registered as Futures Commission Merchants ("FCMs") with the CFTC and are members of the National Futures Association (NFA) ("FCM CMs").

Clients of the FCM Clearing Members ("FCM Clients") can be customers located in the following jurisdictions:

- EU & EEA
- Australia
- Bermuda
- British Virgin Islands
- Cayman Islands
- Guernsey
- Jersey
- Switzerland
- UAE
- U.S.

Financial admission requirements

Proof of sufficient net adjusted capital is provided by obtaining a copy of the return the FCM Clearing Member ("FCM CM") would usually provide to its home regulator (i.e. CFTC 1-FR-FCM). The minimum static amount required is the US dollar equivalent of €30 million, whereas a dynamic component of 20 percent of the Initial Margin requirement applies, if higher.

During the onboarding process, Eurex Clearing performs an internal credit assessment and requires the following information from the applicant:

- Audited Financial Statements - balance sheet and income statements (last three years)
- Quarterly Financial Statements - balance sheet and income statements (preferably covering latest five quarters)
- Latest audited Financial Statement of parent holding company (if applicable)

FCM CMs must contribute to the CCP default fund. The minimum static amount required is equivalent of €5 million upon admission (with a dynamic requirement of 7 percent of the Initial Margin requirement, if higher after start of clearing activity)

Additionally, CFTC Regulation 39.13 requires Eurex Clearing to review the risk management policies, procedures, and practices of each Clearing Member on a periodic basis. Thus, completing a risk assessment is a prerequisite for membership approval.

Operational admission requirements

FCM CMs are required to have at least one Qualified Clearing Staff (QCS). In addition, further Clearing and day-to-day contacts' contact details will have to be entered into the Eurex Clearing Member Section on the Eurex Clearing website. An emergency contact must be available during regular business hours (8:00 am – 10:00 pm CET).

With regards to the transaction flow, the LSOC model will be built on the well-established EurexOTC Clear Service approach. Upon execution at a connected Approved Trade Source (ATS) between the FCM Client and its counterparty, the transaction is automatically sent to Eurex Clearing comprising a unique identifier of the relevant counterparties (e.g. “Markitwire BIC”).

Products and collateral

Product scope

For initial launch, the LSOC model accommodates plain vanilla Interest Rate Swaps, Overnight Index Swaps and Forward Rate Agreements. Supported product currencies are the main currencies euro, US dollar and British Pound.

Cash and payment infrastructure

Eurex Clearing, as well as the FCM CMs, are required to maintain at least one separate dedicated FCM Client account at each permitted depository (according to CFTC Regulation 22.4) involved in the flow of Initial Margin. This applies to cash and securities collateral. Each permitted depository is required to sign an acknowledgement letter in relation to the relevant accounts holding customer funds in accordance with CFTC Regulations 1.20 and 22.5.

Under the LSOC model, Eurex Clearing accepts euro for initial margin payments and cash collateral to cover intraday margin calls. Overnight margin calls will only take place in the FCM CM’s clearing currency which is euro.

The end of day margin call with respect to the relevant collateral pool is issued at 9:00 am CET and must be settled by 10:00 am CET.

Detailed information with regards to cut-off times for euro deposits can be found on Eurex Clearing’s website.

Any release of cash collateral has to be verified and approved by Eurex Clearing.

Product related payments, such as variation margin, are settled in the underlying product currency which can be euro, US dollar and British Pound in accordance with the LSOC product scope.

Securities collateral

Under the LSOC model, Eurex Clearing only accepts a subset of the general admissible securities list. The relevant jurisdictions are the U.S., Germany, France, UK, Canada and Japan. Securities collateral will be provided to Eurex Clearing via a German law pledge.

A list with the admissible securities is updated daily and published on Eurex Clearing’s website.

Please click here for a daily updated list of acceptable collateral (admissible securities).

There is no re-evaluation of collateral with the new FX rates at 5:00 pm CET.

Clearstream Banking Frankfurt (“CBF”) is acting as collateral location for the LSOC model; dedicated CBF-I accounts shall be used for the service. Further details with regards to the cut-off times for the delivery or the release of securities collateral under the LSOC model can be found on Eurex Clearing’s website. Any release of securities collateral must be verified and approved by Eurex Clearing.

LSOC model

Following the Dodd-Frank-Act Wall Street Reform and Consumer Protection Act, the CFTC introduced a new mandatory segregation concept with regards to swap clearing in the U.S. This concept is called LSOC and stands for “Legally Segregated, Operationally Commingled” and is addressed in Part 22 of the CFTC Regulations.

The primary objective of LSOC is to minimise the FCM Client’s “fellow customer risk" i.e. the risk that an FCM Client of an FCM Clearing Member could sustain losses in case of a default or insolvency of the FCM Clearing Member or other FCM Clients of such an FCM Clearing Member. Such rules require that a DCO is restricted from utilising the value of margin assets allocated to one FCM Client to meet the obligations arising from Own Transactions of the FCM Clearing Member and from FCM Client Transactions of another FCM Client.

“LSOC Without Excess” is the basic version of Eurex Clearing’s LSOC model. It offers the full protection of an LSOC model, but does not allow for customer’s excess collateral to be segregated at Eurex Clearing. The functional roll-out of “LSOC Without Excess” is planned for 2019.

In case the FCM Clearing Member wants to provide excess collateral for one or more of its FCM Clients, the FCM CM is required by the CFTC Part 22 Regulation to report to Eurex Clearing the value of collateral assigned to each FCM Client. “LSOC with Excess” can be elected on collateral pool level, i.e. in relation to each LSOC collateral pool, the FCM CM can choose whether they opt for the “LSOC with Excess”. Under “LSOC with Excess”, the Legally Segregated Values (LSVs) and the FCM Buffer are provided by the FCM CM using a so-called Collateral Value Report (CVR). “LSOC with Excess” will be offered with the initial launch.

For further information, please refer to the LSOC whitepaper on the Eurex Clearing website.

If you have any questions or need further information, please contact your Key Account Manager Clearing, e-mail: clearing.services-admission@eurexclearing.com.

20 December 2018