

CONSULTATION  
PAPER

# CONSULTATION PAPER

on technical advice on standard formula capital requirements for direct exposures to qualifying central counterparties

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eiopa

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## RESPONDING TO THIS PAPER

EIOPA welcomes comments on the consultation paper on EIOPA Advice on standard formula capital requirements for direct exposures to qualifying central counterparties.

Comments are most helpful if they:

- ▶ respond to the question stated, where applicable;
- ▶ contain a clear rationale; and
- ▶ describe any alternatives EIOPA should consider.

Please send your comments to EIOPA by Wednesday, 23 October 2024, 23:59 CET responding to the questions in the survey provided at the following link:

<https://ec.europa.eu/eusurvey/runner/PublicConsultationCCP2024>

Contributions not provided using the survey or submitted after the deadline will not be processed. In case you have any questions please contact [SolvencyIIreview@eiopa.europa.eu](mailto:SolvencyIIreview@eiopa.europa.eu).

### Publication of responses

Your responses will be published on the EIOPA website unless: you request to treat them confidentially, or they are unlawful, or they would infringe the rights of any third party. Please, indicate clearly and prominently in your submission any part you do not wish to be publicly disclosed. EIOPA may also publish a summary of the survey input received on its website.

Please note that EIOPA is subject to Regulation (EC) No 1049/2001 regarding public access to documents and EIOPA's rules on public access to documents.<sup>1</sup>

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<sup>1</sup> [Public Access to Documents.](#)

# 1. INTRODUCTION

## 1.1. CALL FOR ADVICE

On 30 April 2024, the European Commission requested from EIOPA technical advice<sup>2</sup> on the standard formula capital requirements for exposures to qualifying central counterparties when undertakings become direct clearing members. The deadline for the advice is 31 January 2025.

EIOPA provides this draft advice for consultation in accordance with Article 16a of Regulation (EU) No 1094/2010.

## 1.2. CONTEXT

Under Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms (CRR)<sup>3</sup>, a qualifying central counterparty is either a central counterparty established and authorised in the EU in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (EMIR)<sup>4</sup> or a central counterparty established in a third country and recognised by ESMA in accordance with EMIR. Central counterparties and qualifying central counterparties are named CCPs and QCCPs respectively hereafter in the document.

Central clearing is the process of guaranteeing financial transactions and mitigating the risk of default by streamlining operations through a central counterparty and establishing multiple layers of financial protection.

This process simplifies operations by shifting from non-central to central clearing of exposures and by allowing for the netting of exposures through a CCP. A stylised illustration of that shift can be found in the left panel of graph 1.

The right panel of graph 1 illustrates this CCP waterfall in a stylised manner. The CCP waterfall involves a sequence of resources that are used in the case of a CCP member's default. First the defaulter's prefunded resources such as margins and default fund contributions are used. If these are exhausted, the CCP's own capital is used. Next, surviving members' contributions to the default fund are utilised, and lastly, any unfunded resources are called upon. This structure ensures multiple layers of financial protection.

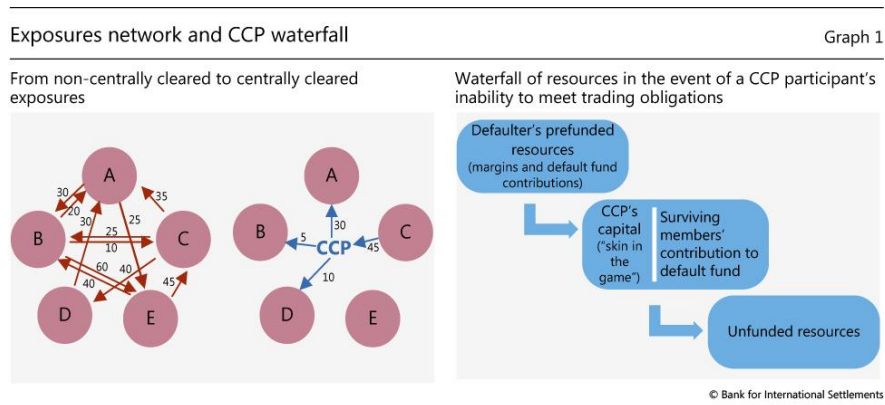
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<sup>2</sup> [Request to EIOPA for technical advice on the review of specific items in the Solvency II Delegated Regulation \(Delegated Regulation \(EU\) 2015/35\)](#)

<sup>3</sup> OJ L 176, 27.6.2013, p. 1–337

<sup>4</sup> OJ L 201, 27.7.2012, p. 1–59

**Graph 1. Exposures network and CCP waterfall**



Source: [BIS Quarterly Review](#) | December 2015 | 06 December 2015

Contributions to the default fund can be prefunded or unfunded. In the case of prefunded contributions to the default fund, the assets are paid ex ante to the CCP. In the case of unfunded contributions, it is a promise to pay in the future in case it is needed. The unfunded contribution is limited by EMIR.

So far, EEA insurance and reinsurance undertakings have engaged with CCPs indirectly as clients, through the intermediation of a clearing member. In this case, the client pays the clearing member fees for its services along with margin payments, while the clearing member makes prefunded contributions to the CCP. Often, clearing members charge additional margins from their clients compared to the margins required by the CCP to cope for additional risks, e.g., for the timelines and frequencies of CCPs' margin calls that cannot be passed on to clients one-to-one.

Solvency II has included a specific treatment for indirect clearing for derivatives that was introduced in 2019. A specific treatment for direct clearing was not introduced. As a result, direct clearing would be treated as a bilateral exposure and therefore would result in higher capital requirements than indirect clearing.

At present, no EEA insurance or reinsurance undertaking has been identified as being a traditional clearing member with direct exposure to a CCP. The Bank of International Settlement has noted that national law might prohibit insurance undertakings from direct clearing due to restrictions on contributing to loss mutualisation mechanisms, such as a CCP's default fund<sup>5</sup>.

Default fund contributions are collective financial resources provided by clearing members to the CCP. The default fund is managed by the CCP and may be used by the CCP to cover losses arising from a member's default. These mechanisms could expose insurance and reinsurance undertakings to significant financial liabilities and, for insurance undertakings, may be in conflict with Article 18(1)(a)

<sup>5</sup> Cf. BIS "Client clearing: access and portability", September 2022, page 16, <https://www.bis.org/cpmi/publ/d210.pdf>

of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)<sup>6</sup>.

To address this, new access models have been developed by CCPs, such as sponsored models, where insurers can become direct members of a CCP while a sponsor is responsible for the default fund contributions. The sponsor is also a clearing member at the CCP, and usually a credit institution. In indirect clearing, the client participates to the CCP through a clearing member and has no contractual relationship with the CCP. In contrast, in sponsored models the client has a direct contractual relationship with the CCP (e.g. as regards margins), facilitated by a sponsor who handles default fund contributions and default management obligations.

At present, several EEA insurance or reinsurance undertakings have been identified as using the sponsored model. This was in particular the case for repurchase transactions (repos). Note that EMIR requires central clearing of derivatives, but not of repos.

The scope of this advice covers the exposures to QCCPs for derivatives as these are the financial instruments in scope of compulsory central clearing according to EMIR.

### **1.3. STRUCTURE OF THE DRAFT ADVICE**

The draft advice provides concrete and specific standard formula requirements for derivative exposures to QCCPs when insurance and reinsurance undertakings become clearing members.

It is articulated in the following sections:

- ▶ Extract from the call for advice
- ▶ Relevant legal provisions, previous EIOPA advice and other regulatory background
- ▶ Identification of the issue
- ▶ Analysis of the policy options and impact assessment
- ▶ EIOPA's draft advice
- ▶ Questions to stakeholders

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<sup>6</sup> OJ L 335, 17.12.2009, p. 1–155

## 2. DRAFT ADVICE

### 2.1. EXTRACT FROM THE CALL FOR ADVICE

#### ***B. Standard formula capital requirements for direct exposures to qualifying central counterparties (CCPs)***

*Under the Solvency II framework, the CCP-related exposures of insurance and reinsurance companies wishing to become direct CCP members can be subject to higher capital requirements than those companies which act as indirect clearing participants.*

*These higher capital requirements can be a disincentive to use these new access models and are not consistent with the idea that CCPs reduce counterparty risk.*

*We request EIOPA to provide technical advice on concrete and specific standard formula capital requirements for exposures to qualifying CCPs when insurance and reinsurance undertakings become direct clearing members, with the aim of ensuring greater consistency in the treatment applicable to such exposures and properly recognising the risk-reducing role of CCPs in terms of counterparty credit risk.*

*When developing its advice, EIOPA should take the prudential treatment under Regulation (EU) No 575/2013 into account.*

*We also encourage EIOPA to liaise with ESMA and EBA on the topic, as necessary and appropriate.*

### 2.2. RELEVANT LEGAL PROVISIONS

Articles 189 to 202 of the Commission Delegated Regulation (EU) 2015/35<sup>7</sup> (Delegated Regulation) set out the calculation of the counterparty default risk module. In particular, Article 192a sets out the calculation of the loss-given-default for the indirect exposure to QCCPs for derivatives. Article 199(12) and (13) set out the probability of default for the indirect exposure to QCCPs for derivatives.

### 2.3. PREVIOUS EIOPA ADVICE

In 2018, EIOPA advised on the prudential treatment for indirect exposure to QCCPs for derivatives<sup>8</sup>. There was no corresponding advice for direct clearing due to the absence of EEA insurance or reinsurance undertakings being clearing members and of any indications that undertakings were interested in becoming clearing members.

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<sup>7</sup> Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 12, 17.1.2015, p. 1–797)

<sup>8</sup> EIOPA's second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation (EIOPA-BoS-18/075), [https://register.eiopa.europa.eu/Publications/Consultations/EIOPA-18-075-EIOPA Second set of Advice on SII DR Review.pdf](https://register.eiopa.europa.eu/Publications/Consultations/EIOPA-18-075-EIOPA%20Second%20set%20of%20Advice%20on%20SII%20DR%20Review.pdf)

The treatment of derivatives with indirect exposure to QCCPs in the standard formula was developed by ensuring relative consistency with the treatment in the CRR. That means the Solvency II capital requirements for indirect exposures were calibrated in such a way that the ratio of capital requirements between indirect exposure and bilateral exposure under Solvency II and CRR are the same.

In CRR, indirect exposure receives a 2% risk weighting if certain conditions are met, and 4% if only some of those conditions are met. In order to achieve the target ratio, the loss-given-default (LGD) factors and probabilities of default (PD) for indirect exposures under Solvency II were specified in Articles 192 and 199 of the Delegated Regulation as follows.

**Table 1: Solvency II parameters for derivatives with indirect exposure to QCCPs**

	<b>LGD factor</b>	<b>PD</b>
<b>Conditions are met</b>	18%	0.002%
<b>Conditions are partly met</b>	16%	0.010%

**2.4. OTHER REGULATORY BACKGROUND**

The prudential treatment of clearing activities under CRR is set out below along with the detailed CRR references to the relevant articles.

**Table 2: CRR parameters for indirect and direct exposure to QCCPs**

<b>Exposure Type</b>	<b>Credit Risk Weight (CRW)</b>	<b>CRR Reference</b>
<b>Direct exposure to QCCP Clearing member trading on own account</b>	2%	Article 306(1)(a)
<b>Indirect exposure QCCP Client</b>	2% or 4%, depending on level of protection <sup>9</sup>	Article 305
<b>Pre-funded contribution to QCCP’s default fund Clearing member</b>	2% floor, potentially higher if concentrated <sup>10</sup>	Article 308
<b>Unfunded contribution to QCCP’s default fund Clearing member</b>	0%	Article 310

According to CRR, direct exposure to a QCCP receives a 2% risk weight. This treatment aligns with that for indirect exposure to a QCCP with the highest level of protection and for prefunded contributions to the QCCP default fund, unless the contribution is highly concentrated. Unfunded contribution to the QCCP default fund receives a 0% risk weight.

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<sup>9</sup> CRR Article 305 allows for a risk weight of 2% if the client is protected from losses in the event the clearing member and another client member jointly default. Otherwise the risk weight of 4 % applies.  
<sup>10</sup> CRR Article 308 allows for a risk weight higher than 2%, if the portion of a clearing member’s default contributions is significant relative to the total contributions from all clearing members and the CCP. Note the formula in this article references Regulation 648/2012/EU (EMIR).



## 2.5. IDENTIFICATION OF THE ISSUE

The absence of a dedicated treatment for direct exposure to QCCPs within the regulatory framework results in these exposures being treated as bilateral exposures. Consequently, concerns arise regarding the risk-sensitivity of this approach and the potential disincentives it could create towards direct clearing.

## 2.6. ANALYSIS

In 2018, EIOPA assessed how developments related to EMIR should be reflected in Solvency II, focusing on indirect exposures to QCCPs for derivatives. EIOPA concluded that the collection of variation margin and compensation for losses of already collected margin lowers the counterparty default risk compared to bilateral arrangements. This mechanism also applies to direct exposures to QCCPs, reducing counterparty default risk in this case as well.

As for indirect exposures, sponsored models carry portability risk<sup>11</sup>, which is accounted for in the current treatment of indirect exposures. In contrast, traditional direct clearing does not carry portability risk but involves additional risk due to exposure to the default fund.

For direct exposures, the current prudential treatment is the general counterparty default risk calculation, calibrated for bilateral transactions. In particular, members need to apply the counterparty default risk sub-module to contributions to the default fund<sup>12</sup>. Prefunded contributions are expected to be treated as type 2 counterparty default risk under Article 189(3), while the treatment of unfunded contributions is less clear and could be considered type 1 exposures under Article 189(2)(e). In accordance with Guideline 9 of EIOPA's Guidelines on the treatment of market and counterparty risk exposures in the standard formula, the type 1 treatment requires separate calculations for each clearing member, potentially resulting in a burdensome process.

When insurance and reinsurance undertakings become clearing members, their liquidity risk profile may change significantly. EIOPA expects those undertakings to manage this liquidity risk appropriately.

### Policy options

The policy options proposed are as follows:

#### Option 1: No change.

In this option, the current treatment of direct exposure to QCCPs is maintained. Default fund contributions remain subject to counterparty default stresses. Prefunded contributions are treated as

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<sup>11</sup> Upon a client clearing service provider (CCSP)'s default, a CCP must promptly port or liquidate the client account. If no CCSP agrees to take the client account, a CCP must liquidate the client positions. The same issue can emerge in sponsored models upon sponsor default as sponsors constitute a subset of CCSPs (BIS report on client clearing: access and portability, p.9 and p. 16).

<sup>12</sup> The value of the assets provided as prefunded contributions would be likely to appear on the Solvency II balance sheet as assets, whereas any unfunded contributions would likely give rise to a contingent liability.

type 2 counterparty default risk, while unfunded contributions are treated as type 1 counterparty default risk.

**Option 2: Extend treatment of indirect exposure to direct exposure to QCCPs.**

In this option, direct exposures to QCCPs are treated in the same way as indirect exposures. There is no change to the current treatment of default fund contributions.

**Option 3: Further align the treatment of default fund contributions to CRR.**

In option 3, direct exposures to QCCPs are treated in the same way as indirect exposures (same as in option 2). Additionally, and in line with the CRR treatment, prefunded contributions to the default fund are treated in the same way as direct exposure to QCCPs and unfunded contributions to the default fund are not stressed. Both prefunded and unfunded contributions are type 1 exposures under the counterparty default risk module.

**Impact of the policy options**

<b>Option 1: No change</b>		
<b>Costs</b>	Policyholders	No material impact
	Insurance and reinsurance undertakings	Prudential treatment of unfunded contributions to the default fund is potentially burdensome
	Supervisory authorities	Prudential treatment of unfunded contributions to the default fund is difficult to supervise
	Other	Prudential treatment does not reflect the risk in relation to direct exposure to QCCPs and may disincentivise undertakings to become direct members
<b>Benefits</b>	Policyholders	No material impact
	Insurance and reinsurance undertakings	No material impact
	Supervisory authorities	No material impact
	Other	No material impact
<b>Option 2: Extend treatment of indirect exposure to direct exposure to QCCPs.</b>		
<b>Costs</b>	Policyholders	No material impact
	Insurance and reinsurance undertakings	Prudential treatment of unfunded contributions to the default fund is potentially burdensome
	Supervisory authorities	Prudential treatment of unfunded contributions to the default fund is difficult to supervise

	Other	No material impact
Benefits	Policyholders	No material impact
	Insurance and reinsurance undertakings	Prudential capital treatment on direct exposure to QCCPs is more risk sensitive
	Supervisory authorities	No material impact
	Other	No material impact
<b>Option 3: Further align the treatment of default fund contributions to CRR</b>		
Costs	Policyholders	No material impact
	Insurance and reinsurance undertakings	No material impact
	Supervisory authorities	No material impact
	Other	No material impact
Benefits	Policyholders	No material impact
	Insurance and reinsurance undertakings	Prudential capital treatment for direct exposure to QCCPs and default fund contributions is more risk sensitive
	Supervisory authorities	No material impact
	Other	No material impact

### Comparison of policy options

Policy option 1 does not recognise the risk specifics of new access models and direct exposure to QCCPs.

Policy option 2 provides aligned prudential treatment for direct and indirect exposure to QCCPs and is considered to be more risk sensitive than option 1. This option may however not capture the particularities of the default fund contributions because the current counterparty default risk module was not designed for such exposures.

Policy option 3 is preferred, as it also provides a simplified treatment of contributions to the default fund that is consistent with the CRR treatment and is more risk sensitive for funded contributions.

## 2.7. DRAFT ADVICE

EIOPA recommends aligning the treatment of direct QCCP derivative exposures under Solvency II to the treatment under CRR (option 3), using the “relative consistency” approach adopted for indirect QCCP derivative exposures. Concretely that implies the following changes to the Delegated Regulation:

- ▶ To extend Article 192a(1) to capture derivative transactions involving direct exposures to QCCPs. This would then be automatically reflected in the reading of Article 192(3) and Article 199(12) and ensure that these transactions are treated consistently with derivative transactions involving indirect exposures to QCCPs.
- ▶ To explicitly include prefunded and unfunded contributions to the default fund of a QCCP in the scope of type 1 exposures as set out in Article 189(2).
- ▶ To extend Article 192 to include a new paragraph 7 which specifies treatment of prefunded contributions to the default fund of a QCCP, setting the loss-given-default to be equal to 18% of the contributions; and a new paragraph 8 which specifies treatment of unfunded contributions to the default fund of a QCCP, setting the loss-given-default to be equal to 0% of the contributions.
- ▶ To extend Article 199(12) to capture the new paragraphs 7 and 8 of Article 192, in order to have the appropriate probability of default used in the capital requirement calculation, such that – in combination with the loss-given-defaults established in Article 192 – relative consistency with the CRR capital treatment is achieved.

### 3. QUESTIONS TO STAKEHOLDERS

- EIOPA is exploring to extend the proposed approach for derivatives to repurchase transactions and possibly other securities. Would you consider such an extension appropriate? If yes, should exposures to QCCPs for repurchase transactions and other securities be treated in the same way as exposures to QCCPs for derivatives? Do these exposures have specificities that need to be considered?
- Do you have comments on the current treatment of direct exposures to QCCPs in Solvency II?
- Do you have comments on the treatment of liquidity risk faced by insurance and reinsurance undertakings when they are members of a QCCP?

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3. Westhafenplatz 1, 60327 Frankfurt am Main, Germany  
fausto.parente@eiopa.europa.eu

### Contact details of EIOPA's Data Protection Officer

4. Westhafenplatz 1, 60327 Frankfurt am Main, Germany  
dpo@eiopa.europa.eu

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7. EIOPA Regulation, and more precisely Article 10, 15 and 16 thereof.
8. EIOPA's Public Statement on Public Consultations.

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