

## Chapter 10

# Firms acting as clearing members and indirect clearing firms

## 10.1 Application

10.1.1 **R** This chapter applies to a *MIFIDPRU investment firm* that is:

- (1) a *clearing member*; or
- (2) an *indirect clearing firm*.

10.1.2 **R** This chapter also applies to the *UK parent entity of an investment firm group* that contains a *clearing member* or an *indirect clearing firm*.



## **10.2 Categorisation of clearing firms as non-SNI MIFIDPRU investment firms**

**10.2.1** **R** (1) A MIFIDPRU investment firm that is a clearing member or an indirect clearing firm is a non-SNI MIFIDPRU investment firm.

(2) The classification in (1) applies irrespective of whether the firm satisfies the conditions in ■ MIFIDPRU 1.2 (SNI MIFIDPRU investment firms) or not.

**10.2.2** **R** (1) This rule applies where:

(a) an investment firm group contains a clearing member or an indirect clearing firm; and

(b) the UK parent entity of the investment firm group in (a) is subject to prudential consolidation in accordance with ■ MIFIDPRU 2.5.

(2) Where this rule applies, the UK parent entity in (1) must comply with the relevant obligations in MIFIDPRU on a consolidated basis as if it were a non-SNI MIFIDPRU investment firm.

(3) The requirement in (2) applies irrespective of whether the UK parent entity satisfies the conditions in ■ MIFIDPRU 2.5.21R or not.

**10.2.3** **R** (1) The effect of ■ MIFIDPRU 10.2.1R is that a firm that acts as a clearing member or indirect clearing firm will always be a non-SNI MIFIDPRU investment firm. This is the case even where the firm may otherwise satisfy all the other criteria in ■ MIFIDPRU 1.2 to be classified as an SNI MIFIDPRU investment firm.

(2) The effect of ■ MIFIDPRU 10.2.2R is that where the consolidated situation of a UK parent entity includes a clearing member or indirect clearing firm, the UK parent entity will always be a non-SNI MIFIDPRU investment firm on a consolidated basis.

(3) ■ MIFIDPRU 10.2.1R applies equally to a firm that is a self-clearing firm.

## 10.3 Application of K-DTF requirement to clearing activities

### 10.3.1

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- (1) This *rule* applies to transactions in *financial instruments* in relation to which a *MIFIDPRU investment firm* provides clearing services in its capacity as a *clearing member* or an *indirect clearing firm*.
- (2) Except where ■ MIFIDPRU 10.3.2R applies, a *firm* must include the transactions in (1) in its calculation of *DTF* for the purposes of the *K-DTF requirement* in accordance with the remainder of this *rule*.
- (3) The transactions in (1) must be included in a *firm's DTF* on the following basis:
  - (a) where the order that gave rise to the clearing transaction was a *cash trade*, the clearing transaction must also be treated as if it were a *cash trade* (irrespective of whether it would otherwise meet that definition); and
  - (b) where the order that gave rise to the clearing transaction was a *derivatives trade*, the clearing transaction must also be treated as if it were a *derivatives trade* (irrespective of whether it would otherwise meet that definition).

### 10.3.2

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- (1) This *rule* applies where a *firm*:
  - (a) executes an order:
    - (i) in its own name (whether for its own account or on behalf of a *client*); or
    - (ii) in the name of a *client*; and
  - (b) also provides clearing services in its capacity as a *clearing member* or *indirect clearing firm* in relation to a transaction that results from the order in (a).
- (2) Where this *rule* applies, the value of the relevant order in (1)(a) is not included in the *firm's* measurement of *DTF* attributable to clearing services under ■ MIFIDPRU 10.3.1R, provided that the value of the order has already been included in one of the following in relation to the *firm's* execution services:
  - (a) the calculation of the *firm's COH* under ■ MIFIDPRU 4.10 (K-COH requirement); or
  - (b) the calculation of the *firm's DTF* under ■ MIFIDPRU 4.15 (K-DTF requirement).

- 10.3.3 **G**
- (1) ■ MIFIDPRU 10.3.1R requires a *MIFIDPRU investment firm* to calculate an additional *K-DTF requirement* for any clearing transactions it undertakes in relation to *financial instruments*.
  - (2) ■ MIFIDPRU 10.3.2R applies to a *MIFIDPRU investment firm* that both executes an order and subsequently provides clearing services in relation to the resulting transaction (including where the *firm* is acting as a *self-clearing firm*). In this case, the *firm* is not required to include the clearing transaction in its calculation of *DTF*, provided that the value of the original executed order has already been included in either the *firm's* measurement of its *DTF* or *COH*.
  - (3) The intention of ■ MIFIDPRU 10.3.2R is that a *firm* is not required to “double-count” the value of the original order and the resulting clearing transaction where the *firm* is involved in both executing and clearing the same trade.
- 10.3.4 **R**
- Where prudential consolidation applies to a *UK parent entity* under ■ MIFIDPRU 2.5.7R, the *UK parent entity* must include within the calculation of its consolidated *K-DTF requirement* any transactions that are cleared by *clearing members* or *indirect clearing firms* that are included within its *consolidated situation*.

## 10.4 Own funds requirement for CCP default fund exposures

10.4.1 **R** This section applies to:

- (1) a *MIFIDPRU investment firm* that is a *clearing member*; and
- (2) a *UK parent entity* to which consolidation under **■ MIFIDPRU 2.5.7R** applies, where the relevant *investment firm group* includes one or more *clearing members*.

10.4.2 **R**

- (1) A *MIFIDPRU investment firm* must include its pre-funded contributions to the default fund of a *CCP* in the calculation of its *K-TCD requirement* in accordance with the remainder of this *rule*.
- (2) The *firm* must apply the *rules* and guidance in **■ MIFIDPRU 4.14** (K-TCD requirement) in relation to the relevant default contribution with the following modifications:
  - (a) the transactions specified in **■ MIFIDPRU 4.14.3R** are deemed to include pre-funded contributions made by the *firm* to the default fund of a *CCP*;
  - (b) for the purposes of **■ MIFIDPRU 4.14.7R**, the value of  $\alpha$  shall be 1;
  - (c) for the purposes of **■ MIFIDPRU 4.14.9R**, the replacement cost (RC) of the default fund contribution is the book value of that asset in accordance with the applicable accounting framework;
  - (d) for the purposes of **■ MIFIDPRU 4.14.29R**, the applicable risk factor is:
    - (i) the value of a C-factor calculated in accordance with the methodology in **■ MIFIDPRU 10.4.3R** where that C-factor has been published by an *authorised central counterparty* in relation to the default fund of the *CCP*;
    - (ii) in the case of an *authorised central counterparty* that has not published a C-factor relating to its default fund, 1.6%; and
    - (iii) where the *CCP* is not an *authorised central counterparty*, 8%; and
  - (e) for the purposes of **■ MIFIDPRU 4.14.30R**, the credit valuation adjustment (CVA) is 1.

10.4.3

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- (1) For the purposes of ■ MIFIDPRU 10.4.2R(2)(d), a C-factor is:
- (a) in the case of an *authorised central counterparty* that is subject to national rules implementing the requirements in BCBS 282 (Capital requirements for bank exposures to central counterparties) published by the Basel Committee on Banking Supervision in April 2014, a value determined in accordance with the formula in (2); or
  - (b) in the case of any other *authorised central counterparty*, a value determined in accordance with the formula in (3).

The relevant formula under (1)(a) is:

$$\text{C-factor} = \max\left(\frac{K_{CCP}}{DF_{CCP} + DF_{CM^{pref}}}; 8\% \cdot 2\%\right)$$

where, in each case, the values of  $K_{CCP}$ ,  $DF_{CCP}$  and  $DF_{CM^{pref}}$  are calculated in accordance with the methodology in BCBS 282.

- (3) The relevant formula under (1)(b) is:

$$\text{C-factor} = \left(1 + \beta \cdot \frac{N}{N - 2}\right) \cdot \frac{K_{CM}}{DF_{CM}}$$

where, in each case, the values of  $\beta$ ,  $N$ ,  $K_{CM}$  and  $DF_{CM}$  are calculated in accordance with the methodology in BCBS 227

(Capital requirements for bank exposures to central counterparties) published by the Basel Committee on Banking Supervision in July 2012.

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An *authorised central counterparty* may publish C-factors for the purposes of national rules implementing both BCBS 227 and BCBS 282. In this case, the effect of ■ MIFIDPRU 10.4.3R(1)(a) is that the C-factor published for the purpose of BCBS 282 must be used. Where the default fund relates to derivatives, the C-factor published for the purposes of the Standardised Approach to Counterparty Credit Risk (SA-CCR) will normally be the relevant C-factor.

10.4.5

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- (1) Where a *MIFIDPRU investment firm* that is a *clearing member* or an *indirect clearing firm* has trade exposures to a *CCP*, it should consider whether the exposures arise from a transaction listed in ■ MIFIDPRU 4.14.3R as being within scope of the *K-TCD requirement*. ■ MIFIDPRU 4.14.3R(1)(a) and ■ MIFIDPRU 4.14.4R exclude from the scope of the *K-TCD requirement* derivatives contracts that are directly or indirectly cleared through an *authorised central counterparty*.
- (2) However, the exclusion in (1) does not apply to a pre-funded contribution of a *clearing member* to the default fund of a *CCP*, as this exposure is not a contract cleared through the *authorised central counterparty*. ■ MIFIDPRU 10.4.2R explains how a *firm* should calculate the *K-TCD requirement* for the contribution.

10.4.6

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Where this section applies to a *UK parent entity* in accordance with ■ MIFIDPRU 10.4.1R(2), the requirement in ■ MIFIDPRU 10.4.2R and the modifications it makes to the *rules and guidance* in ■ MIFIDPRU 4.14 apply to the *UK parent entity* in relation to any pre-funded contributions to the default fund of a CCP made by any entities included within the *consolidated situation*.