

CENTRAL COUNTERPARTIES ON ROMANIAN CAPITAL MARKET

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Abstract

Capital markets refer to clearing as to the process of establishing „positions”, i.e., ownership of a particular security, like a stock or derivative, at a given time, including the calculation of net obligations, and ensuring that financial instruments, cash, or both, are available to secure the exposures arising from those positions.

The calculation of net obligations is a complex process that requires the presence of a new participant: Central Counterpart (CCP).

CCP means a legal person that interposes itself between the parties to the contracts traded on a financial market, becoming the buyer to every seller and the seller to every buyer. Such CCPs know two avatars: central depositories intervene in the stock market for clearing transactions while other companies intervene on derivatives markets. For clarity, the Romanian Law assign the term CCP for derivatives only. Stock market use in clearing process the depository only.

CCPs, have in present a European Regulation, updated several times¹. This regulation marked a turning point on Romania Capital market and in the end led to the disappearance, probably temporary, of the internal market of derivative financial instruments. The companies that operated as clearing companies on the Romanian derivatives market – „Casa Română de Compensatie SA” from Bucharest Stock Exchange group and „Casa de Compensare București SA” from Sibex group – did not meet the new authorization requirements and ceased to participate to derivatives market. Romanian Regulation issued by Romanian Financial Supervisory Authority (FSA)² implemented the European Regulation. The new Romanian Law on financial instruments markets³ enacts the same European rules for CCPs.

Keywords: Derivatives, Central Counterpart (CCP), clearing, BVB, financial instruments.

1. Introduction

The Romanian capital market has known the trading of derivative financial instruments from an early stage. In fact, there was a dedicated market to derivatives in Sibiu, soon followed by another market in Bucharest. Such markets relied on the activity of specialized clearing companies.

The companies that operated as clearing companies on the Romanian derivatives market were „Casa Română de Compensatie SA” from Sibex Sibiu group and „Casa de Compensare București SA” from BVB (Bucharest Stock Exchange) group. Both of them were established under the previous laws of the Capital Market⁴.

The new legal regime for derivatives transactions affected clearing houses. Romanian clearing houses did not meet the new authorization requirements and ceased to participate to derivatives markets. Ultimately, the Romanian derivatives markets were closed. The reopening of these markets has been postponed year after year and is still awaiting its fulfilment.

The European Market Infrastructure Regulation (EMIR) lays down rules on over-the-counter (OTC) derivatives and central counterparties (CCPs)⁵. Derivatives play an important role in mature markets, but they also bring certain risks. During the 2008 financial crisis, significant weaknesses in the OTC derivatives markets became evident. In 2012, the EU adopted the European market infrastructure regulation (EMIR) aiming to increase transparency in the OTC derivatives markets, mitigate credit risk and reduce operational risk. Beyond

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¹ Regulation (EU) no. 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.07.2012, p. 1).

² Regulation no. 3/2013 for authorization and operation CCPs and implementing European Regulation (EU) no. 648/2012 on OTC derivatives, central counterparties and trade repositories (published in the Official Gazette of Romania no. 552/2013).

³ Law no. 126/2018 on financial instruments markets (published in the Official Gazette of Romania no. 521/2018), updated.

⁴ „Casa Română de Compensatie SA” was established under Law no. 52/1993 on securities and stock exchanges. „Casa de Compensare București SA” was established under Law no. 297/2004.

⁵ Regulation (EU) no. 648/2012 of the European Parliament and of the Council.

the stated purpose (OTC derivatives) this regulation laid down rules for CCPs for all European jurisdiction. EMIR regulation has known many updates and delegated regulations.

The new Romanian Law on financial instruments markets⁶ enacts the same European rules for CCPs.

Romanian Regulation issued by FSA implemented the European Regulation by amending an older regulatory act dedicated to CCPs⁷.

2. Paper content

2.1. CCPs role on the derivatives market

Derivative or „derivative contract” means a type of financial instrument in which, in specific form (*i.e.*, futures contract), the effects of the contract are postponed until a future date. Types of derivatives are laid down in MiFID II Directive⁸, points (4) to (10) of Section C of Annex I (common derivatives include futures contracts, forwards, options, and swaps). Furthermore the term „derivative” refers to a type of financial contract whose value is dependent on an underlying asset, a group of assets, or a benchmark and prices for derivatives derive from fluctuations in the prices of underlying assets. Derivatives are agreements set between two or more parties that can be traded on an exchange.

Investments firm (intermediaries) acting in a venue for derivatives are required to report the details of derivative contracts and shall ensure that such details are reported correctly.

Not all derivatives (futures contracts) are settled at expiration by delivering the underlying asset. In fact, it is unlikely counterparties would want to make arrangements for the delivery of underlying asset (if there are commodities). Usually, parties on a regulated market shall end their obligation to purchase or deliver the underlying asset by closing (unwinding) their contract before expiration with an offsetting contract. Derivatives listed on regulated markets are, in fact, cash-settled, which means that the gain or loss in the trade is simply an accounting cash flow to the parties’ brokerage account. Futures contracts that are cash-settled include many interest rate futures, stock index futures, and more unusual instruments such as volatility futures or weather futures.

Derivatives trading uses the market's single clearing system. This is where the CCP comes in, responsible for registering contracts and executing them. CCP is a legal person that interposes itself between the parties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer⁹.

Through the intervention of the CCP, each party remains contractually bound only to this participant. The link between the parties is broken. These parties are left with only one „position” (named „long” or „short”), a legal relationship with CCP only. Other roles of CCPs includes market marking, margins administration and margin call.

Marking to market¹⁰ refers to the daily settling of gains and losses due to changes in the market value of underlying asset (If the value of the security goes up on a given trading day, the trader who bought the security (the long position) faces increased value – equal to the security’s change in value – and the trader who sold the security (the short position) faces decreased value. Conversely, increasing or decreasing value impact on guaranties laid down in contract, margins. In derivative trading, „margin”¹¹ refers to the value (amount of money or equity or equivalent) an investor must maintain in their brokerage account in order to maintain his position (maintenance margin). These funds function as security, protecting against potential losses that might occur during the trading process. A margin call is the demand that an investor deposit additional money or securities so the account is brought up to the minimum value known as the maintenance margin. A margin call¹² usually means that one or more of the securities held in the margin account have decreased in value below a

⁶ Law no. 126/2018 on financial instruments markets (published in the Official Gazette of Romania no. 521/2018), updated.

⁷ FSA Regulation no. 3/2013 for authorization and operation CCPs and implementing European Regulation (EU) no. 648/2012 on OTC derivatives, central counterparties and trade repositories (published in the Official Gazette of Romania no. 552/2013)

⁸ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173/12.06.2014, p. 349).

⁹ Art. 2 para. (1) of Regulation (EU) no. 648/2012.

¹⁰ Art. 2 para. (3) point 8 of FSA Regulation no. 3/2013.

¹¹ Art. 2 para. (3) of FSA Regulation no. 3/2013. The margin account is the account in which the funds or financial instruments established to guarantee the derivative instruments held and the obligations assumed are registered.

¹² Art. 2 para. (3) point 1 of FSA Regulation no. 3/2013.

contractually established point. This process is essential for settling debts, meeting margin requirements, or preventing further losses in trading accounts.

All these activities, registering contract¹³, market marking, margin administration, margin call as well as position liquidation involve CCP. In the context of trading, liquidation refers to the closing of positions, either voluntarily by the trader or forcibly, usually when a margin call occurs.

2.2. Authorisation requirements for CCPs

The legal vision in the case of the CSD (central securities depository) is also valid in the case of the CCPs. FSA does not authorize specialized companies to operate in an abstract manner, by certifying their legal ability to perform particular operations. Thus, the CCP authorization procedure requires the particular contract or contracts concluded with the market operators and system operators of the trading venue, for the transactions in the system of which clearing services are intended to be performed¹⁴.

The CCP uses a payment and settlement system for financial instruments. The banking-type activities provided by the CCP, even if they are ancillary to clearing services, require authorization from the money market supervisory authority too, the National Bank of Romania (BNR)¹⁵. Like the CSD (central depository), the CCP requires a double administrative authorization, which comes from performing of activities that go beyond the capital market in order to enter the money market.

The authorisation of a CCP begins with an application for authorisation submitted to the competent authority (FSA). The application is accompanied by all the information necessary to enable the competent authority to verify whether the applicant CCP complies with the provisions necessary to fulfil the obligations for the purpose of carrying out its business. FSA transmits the application for authorisation to ESMA (the European Authority) together with all the information received from the applicant CCP. The European procedure is established for the issuance of a positive or negative opinion for authorisation by the FSA.

FSA establishes, manages and chairs a college for examining applications for authorization submitted by CCPs under its authority. The college is composed of representatives of FSA, ESMA, the competent authorities responsible for the supervision of significant clearing members of the CCP, the competent authorities responsible for the supervision of trading venues served by the CCP, as well as the competent authorities responsible for the supervision of entities with which there is interoperability¹⁶.

For Romanian CCPs, the College will be composed of (representatives of) FSA, ESMA, ECB (European Central Bank) and BNR. The College is mainly responsible for drafting the opinion for the authorization of the CCP after receiving the FSA report and based on its findings.

FSA issues the administrative act of authorization only if it is certain that the applicant CCP meets all legal requirements (European regulation and domestic legislation). FSA takes into account the opinion of the European College it chairs (for Romania). If the opinion is positive, but FSA does not agree with the authorization, FSA specifies in its decision the reasons on which it is based regarding the significant deviation from the respective positive opinion. However, if all members of the college, except FSA, reach a common negative opinion by consensus, the CCP does not receive the authorization¹⁷.

2.3. Romanian CCPs

The Romanian Clearing House Company Sibex (Sibiu) Stock Exchange is the first regulated market specialized in trading derivative financial instruments and was the only one of this type in Romania until 2007. In 1998, the activity of clearing and settlement of derivative financial instruments transactions on Sibex was taken over by a specialized company, with the establishment of the Romanian Clearing House Company. The futures contracts traded at Sibex were agreements involving the obligation to sell or buy a stock, commodity, currency, financial index (in this case it is a „supporting asset” that mediates the final settlement in funds, without delivery, obviously), having standardized quantity, quality, maturity and execution method.

¹³ Art. 31 of FSA Regulation no. 3/2013. The registration of derivative financial instruments at the CCP is done only through clearing members, according to the mechanisms established by the central counterparty's own regulations.

¹⁴ Art. 4 para. (2) of FSA Regulation no. 3/2013.

¹⁵ Art. 404 of GEO no. 99/2006.

¹⁶ Art. 18 of Regulation (UE) no. 648/2012.

¹⁷ Art. 17 para. (4) of Regulation (UE) no. 648/2012.

The Bucharest Clearing House Company. The Bucharest Stock Exchange decided in 2007, with the failure of the merger negotiations between BMFM Sibiu (Sibex) and BVB, to launch its own futures market. The role of clearing house, Central Counterparty for transactions with derivative financial instruments registered at BVB, was taken over by „Casa de Compensare București” (CCB SA), a company with the object of activity of clearing house.

European regulations designed in response to the global financial crisis that began in 2007-2008 aim for a deeper level of regulation in the field of financial derivatives, including a uniform European regulation of central counterparties as entities responsible for clearing these instruments. These regulations imposed the reauthorization under special prudential conditions (including capital requirements) of Central Counterparties. Regulation (EU) no. 648/2012, with subsequent amendments and subsequent delegated regulations, created a single European framework for central counterparties/clearing houses. The internal legal framework offered several compliance deadlines for domestic central counterparties operating in the field („Casa Română de Compensatie” and „Casa de Compensare București”). Beyond the initial capital requirements, companies of this type in Romania are currently facing a lack of trading venues to serve them. Thus, the Sibex futures market disappeared following the merger by absorption of Sibex SA with BVB SA. In turn, BVB SA, as a market operator, has given up its derivative market. Domestic trading of derivative financial instruments on a regulated market will be given another chance, a situation that requires the authorization of a new central counterparty under domestic law.

CCP.RO Bucharest SA was established to relaunch the derivative market in Romania by offering clearing services for the capital market and the energy market. On the capital market, the founding operator is BVB and on the energy market, the operator is OPCOM. This is the Electricity and Natural Gas Market Operator „OPCOM” SA, managing trading on the electricity, natural gas and green certificate markets.

CCP.RO Bucharest SA was established in 2019, with an initial capital of approximately 17 million euros, with BVB SA as shareholders (59.52% of the capital), the Electricity and Natural Gas Market Operator „OPCOM” S.A. (OPCOM) (19.06%) and other representative companies [Enel România SA, Banca Transilvania SA, Tinmar Energy SA, SIF Banat-Crișana SA (now Lion Capital), SIF Transilvania SA (now Transilvania Investments) etc.].

2.4. BVB market for derivatives

The Romanian capital market has been waiting for several years for the reopening of trading in derivatives. For this purpose, a central counterparty was established (CCP.RO) and BVB SA adopted its own code for the regulated derivatives market. This Code¹⁸ provides general regulatory support regarding market operations with financial derivative instruments based on financial assets as underlying assets that are traded on the regulated market managed by BVB, referred to as the Derivatives Market, in accordance with the provisions of Law no. 126/2018 on trading venues, as well as with the regulations issued by the Financial Supervisory Authority, the European regulations issued in application of Directive 2014/65/EU.

The type of DFIs (derivative financial instruments) that may be subject to this BVB Code concerns: DFIs of the type of futures contracts having as underlying assets capital securities¹⁹ (shares, indices, etc.), interest rate, exchange rate, etc. Futures contracts are those that are traded on the BVB market. The standardized clauses regarding the characteristic elements of futures contracts („futures contract specifications”)²⁰ approved by the Exchange Council (BVB) present the following characteristic elements a) the symbol; b) the underlying asset; c) the size of the contract object („the multiplier”); d) the quotation; e) the basic notional value; f) the initiation months („listed series”); g) the maturity months and the maturity date; h) the first and last trading day; i) information regarding the price at which the daily marking to the market is carried out („the daily settlement price”); j) the method of determining the liquidation price at maturity („the final settlement price”); k) other characteristic elements.

¹⁸ BVB Code, Derivatives Market, approved by FSA authorization no. 25/2024, https://www.bvb.ro/juridic/files/CODUL%20BVB-Piata_Derivatelor%20pe%20active%20suport%20de%20tip%20financiar%20si%20alte%20tipuri%20de%20active.pdf.

¹⁹ BVB Code, Derivatives Market, Preliminary Title, art. 1 point 21, in accordance with point 4 of Section C, Annex no. 1 of Law no. 126/2018.

²⁰ In accordance with the provisions of FSA Regulation no. 13/2018.

3. Conclusions

The Romanian derivatives market is still awaiting the authorization of the central counterparty (CCP) to be functional. The birth of the domestic counterparty (CCP.RO) has proven to be much more difficult.

In the context of a change in European legislation, the application for authorization of CCP.RO submitted at the beginning of 2023 to the FSA is no longer in compliance with the rules.

The launch of a derivatives market is to be submitted after the Central Counterparty adapts to the new conditions, starting this year. The authorization file of the Central Counterparty, the entity on which the settlements of derivative financial instruments would depend, submitted to the market supervisor FSA, is withdrawn by the Board of Directors of CCP.RO Bucharest, given that it is outdated as a result of changes in European legislation.

The evaluation of the CCP.RO authorization file will be subject to a final decision by the FSA after the entry into force of the new European regulatory package (EMIR 3) published in the Official Journal of the EU (04.12.2024). Thus, it is necessary for the authorization process to formally align with the new application documentation flows according to the EMIR 3 framework.

After the authorization of the Central Counterparty, CCP.RO, the derivatives market administered by the BVB can resume its existence.

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