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European Banking Authority

31 July 2012

Dear Sirs

Re: Response to EBA Consultation Paper on draft Regulatory Technical Standards on the Capital Requirements for CCPs under the Regulation on OTC Derivatives, CCPs and Trade Repositories (EBA/CP/2012/08), dated 15 June 2012 (the “Consultation Paper”)

European Central Counterparty Limited (“EuroCCP”) would like to thank the European Banking Authority (“EBA”) for providing this opportunity for industry participants to comment on the proposals set out in the 15 June, 2012 Consultation Paper. EuroCCP is pleased to offer its views based on its experience as a Recognised Clearing House in the UK and European cash equities markets.

In this response, we have first set out what we consider should be the approach, based on principle, to the capitalisation of CCPs. We then comment generally on some of the issues raised by the questions set out in Part V b) of the Consultation Paper.

Use of approaches set out in the Capital Requirements Directive/Capital Requirements Regulation (“CRD/CRR”) to calculate capital requirements for CCPs

We note the observations made in recital 6 of the draft Regulation which advocate the use of the CRD/CRR framework for the purposes of establishing capital requirements to cover operational risk borne by CCPs on the basis that the financial instruments that CCPs clear are the same as those “used” by credit institutions and investment firms. As outlined in our response to the EBA Discussion Paper (EBA/DP/2012/1), dated 6 March 2012, we remain concerned that applying the CRD/CRR framework to CCPs will not produce a correctly calibrated outcome in relation to CCPs as clearing financial instruments, as opposed to trading those same instruments, is an entirely different activity with a very different operational risk profile.

In this respect, if the CRD/CRR framework is applied without modification, we believe those calculations are likely to produce a significant overstatement of the capital requirements needed to ensure that a CCP survives an operational risk event. Accordingly, we recommend that further consideration is given to tailoring the CRD/CRR framework specifically to CCPs via, for example, the use of lower multipliers than currently used in relation to credit institutions and investment firms.

Wind Down Period under Article 6

As outlined in our response to the EBA Discussion Paper, we believe it is important to establish a standard measurement of capital resources to be held against general business losses and that this should be based on an objective requirement. At that time we stated that we supported the maintenance in reserve of an amount of equity capital equal to the period of operating expenses which was to be provided for within Principle 15 of the CPSS-IOSCO Principles for Financial Market Infrastructures.

Principle 15 of the CPSS-IOSCO Principles for Financial Market Infrastructures states that an amount of equity capital equal to a minimum of 6 months current operating expenses should be held subject to an overall obligation to ensure that the amount of equity capital held is reflective of its general risk profile and sufficient to achieve a recovery or orderly wind down as appropriate.

We remain supportive of the approach taken in Principle 15 which provides for a minimum period of 6 months current operating expenses whilst also requiring the CCP to determine whether that minimum period is applicable based on its general business profile and its assessment of the length of time it would require in order to achieve a recovery or orderly wind down. We believe that this approach is both sufficiently conservative and flexible to address the requirements of CCPs operating in a number of different asset classes and markets and note that there does not appear to be any particular body of evidence to suggest that a longer 12 month wind down period is warranted.

In particular, in relation to cash equities markets, we note that with the introduction of interoperability the risk of a trade venue being left without clearing services where a CCP is unable to provide such services is mitigated by the existence of one or more other CCPs which can provide similar services with almost immediate effect under the interoperability model. In general, we believe that the continued adoption and development of interoperability supports our belief that CCPs can either recover or wind down within a 6 month period as alternative clearing services can be made available to clearing members within a very short period permitting failing CCPs to migrate or cease the provision of clearing services well within a 6 month time frame. We would also note that within cash equities markets settlement operates on a T+2 or T+3 basis and, as such, CCP exposures run off over a relatively short period of time which would assist a CCP operating in cash markets to also cease clearing activities relatively quickly and within a 6 month timeframe.

With regard to the definition of what would constitute operational expenses we note that category (e) refers to “other expenses as defined in the applicable accounting framework”. We would request that it be made clear that depreciation and amortisation expenses can be excluded for the purposes of this calculation as these are not cash costs to a business and accordingly we do not believe a CCP should be required to retain a cash pool to cover such costs. We are also unclear why “losses related to operational failures” should constitute an on-going expense when in fact this element is already

covered by the operational risk element of the capital calculation. We believe this category should be excluded.

We would also request that the draft Regulation exclude certain categories of expenses that would not be incurred within a wind down scenario e.g. travel, marketing and promotion expenses.

Discretionary Capital Requirement under Article 9

We do not support the reservation of powers to national competent authorities to require CCPs to hold additional capital beyond Article 3 requirements for a number of reasons:

- CCPs would already be holding the cumulative capital required under Article 3 based on operating expenses (Article 3 (a)) and individual risk calculations under Articles 3 (b) and (c). It is entirely unclear what other risks might be in scope as we find it difficult to see what other legal risk could be identified that would not already be covered under the Article 3 calculation, whilst business risk is addressed via the wind down component of the Article 3(a) calculation. In this respect, with the addition of the powers identified under Article 9, the proposed framework would produce a result which would not be calibrated to a CCP's activities and, at the same time, less transparent and less objectively measurable. It is difficult to see how this assists either CCPs, their members or the regulatory community in ensuring the aims of Article 16 of EMIR are met.
- if the CRD/CRR banking framework were not applied, as we have advocated above, the risk identified in the Explanatory Note to Article 9 would not arise; i.e., if a properly calibrated approach is taken specific to CCPs there would be no need to provide national competent authorities with discretionary powers to require CCPs to hold additional capital.
- the reservation and use of discretionary powers by definition will increase uncertainty regarding the outcome of any single CCP's capital calculation and could potentially lead to very different outcomes in relation to CCPs which have very similar operational profiles. We do not believe this is desirable and the discretionary nature of the potential capital amount raises a number of process issues for each CCP in relation to the capital planning cycle.
- similar uncertainty will be introduced into the calculation of the CCP's contribution to the default waterfall under Article 45 (4) of EMIR unless the component that might be added under Article 9 is expressly excluded from the default waterfall calculation.
- imposing additional capital requirements on CCPs could work against current regulatory goals and act as a disincentive to clearing. This is because, in order to raise new capital, CCPs might be required to raise their transaction costs and fees ultimately charged to its clearing members (who would, in turn, pass these fees on to the end users). An increase in clearing costs may incentivise the

market to structure products in such a way as to avoid clearing altogether (which would clearly be contrary to current regulatory goals).

In our view, if some discretion is to be retained by the national competent authority in relation to the calculation of capital, we believe a better approach would be for the national competent authority to have powers to increase the wind down period over and above the minimum floor. We believe that if the national competent authority had the power to increase that period by up to 3 months that would enable national regulators to exercise prudent oversight, but the process would still remain sufficiently predictable and objective that a CCP would be able to factor this into its capital planning process without undue difficulty.

We also note the proposal to grant national competent authorities an alternate power to require a CCP "to decrease its exposures to risks if deemed necessary". This does not appear to be a matter strictly related to calculation of capital (although we understand the consequence it might have in relation to whether the calculation is compliant with the draft Regulation or not) and as such falls outside the remit of these draft technical standards. We believe that if these powers are devolved to national competent authorities by virtue of Article 21 of EMIR and are to be the subject of level two technical standards then they should not be addressed via this Consultation Paper but within a separate process where additional detail can be provided regarding the rationale and process behind those proposed powers.

Cumulative approach to calculation of under Article 3

Although we note the EBA believes that the cumulative approach to calculation of capital under article 3 is the only approach which meets the requirements of Article 16 of EMIR, this appears to contradict the "higher of" test advocated by the EBA in the Discussion Paper. Notwithstanding any interpretational issues that EBA may be experiencing with the text of Article 16, there is no evident rationale for requiring CCPs to hold capital to cover operational risk in addition to an amount of equity capital equal to current operating expenses covering a minimum number of months. These sums are, in our view, duplicative as they address the same types of risk.

The primary requirement of Article 16 is that capital is proportionate to the risk stemming from the activities of the CCP. In our view it is entirely possible to achieve that aim through a simpler standard measurement of capital resources to be held against risk of loss based on a wind down period approach. As we have stated above, we believe this would avoid applying a complex and costly CRD/CRR framework which would not be correctly calibrated for CCPs whilst still introducing an objective standard which retains some flexibility and provides sufficient certainty for CCP capital planning purposes.

Article 4 – Notification Threshold

Article 4 refers to a notification threshold of 125% of the capital requirement set out under Article 3. This threshold is inconsistent with the range suggested in the

Discussion Paper (105 – 110%) and does not appear to be supported by any particular rationale. It is also unclear what purpose such a large buffer is intended to serve as the original purpose behind an “early warning system” can be adequately addressed via a reporting threshold set at 105% of the actual capital requirement.

We are also concerned that when read in the light of Article 4 (2) (b) the notification threshold will act as a de facto capital requirement as Article 4 (2) (b) requires a CCP to take measures to ensure on going compliance with the capital requirements if a CCP’s capital falls below the notification threshold; i.e., the CCP cannot elect to simply take no action if it falls below the notification threshold but remains above the actual capital requirement. We are also concerned that this de facto threshold would be read across to the calculation of the CCP’s contribution to the default waterfall under Article 45 (4) of EMIR which we believe is an unnecessary and unintentional consequence of the draft Regulation.

If the consequences outlined above are not the intention of Article 4 (2) (b) we would ask that the EBA address this clearly in the final version of the Regulation.

EuroCCP appreciates the opportunity to comment on the Consultation Paper. We would be pleased to provide the EBA with any additional information or analysis that might be useful in determining the final form of the RTS standards. This response is not confidential.

Yours faithfully

Diana Chan
Chief Executive Officer