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2 April 2012

Dear Sirs

Re: Response to EBA Discussion Paper on draft Regulatory Technical Standards on the Capital Requirements for CCPs under the draft Regulation on OTC derivatives, CCPs and Trade Repositories (EBA/DP/2012/1), dated 6 March 2012 (the "Discussion Paper")

1. 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 6 March, 2012 Discussion 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.

2. In this response, we have first set out what we consider should be the approach, based on principle, to the capitalisation of CCPs. This leads us to comment in some detail on the matters relevant to Question 7 in the Discussion Paper. We have given short responses to the other Questions in an Annex.

General capital requirements for CCPs

3. Article 12(2) of EMIR is in the following terms:

   > "Capital, including retained earnings and reserves, of a CCP shall be proportional to the risk stemming from the activities of the CCP. It shall at all times be sufficient to ensure an orderly winding-down or restructuring of the activities over an appropriate time span and that the CCP is adequately protected against credit, counterparty, market, operational, legal and business risks which are not already covered by specific financial resources as referred to in Articles 39 to 41a."

4. We agree that margin and the default fund should be applied against credit and counterparty risk, whilst other resources should be held for non-clearing activities. Therefore, the role for capital is to ensure that there is no market disruption as a result of the CCP being unable to withstand the impact of these general business risks. We do not consider that the role of a CCP's capital is to provide additional resources for credit and counterparty risks which are already provided for under the margin and default fund. This is an important consideration, since the majority of a CCP's risks arise precisely as a result of it acting as central counterparty.

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Expenses for winding-down

5. We support the general approach to capital requirements for potential general business losses proposed in paragraphs 11 – 13 of the Discussion Paper, subject to the following comments.

6. 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. In this respect we support the maintenance in reserve of an amount of equity capital equal to the period of operating expenses which will be provided for within Principle 15 of the CPSS-IOSCO Principles for Financial Market Infrastructures. Accordingly, we do not believe that there is a need to employ a calculation which takes into account an internally estimated time period for wind down as proposed in paragraph 11 of the Discussion Paper.

Operational risks

7. We do not believe that the proposal to cover operational risks by capital measured by methods used for banks in the CRD is appropriate for CCPs. The Discussion Paper (paragraph 15) refers to operational risk arising from activities of investing collateral and the payment and settlement of monies.

8. The usual starting-point for assessment of operational risks is the work of the Basel Committee on Banking Supervision carried out in preparation for Basel II in relation to banks. However, we believe that that their work, while instructive, needs to be applied with caution to the very different business of a CCP.

9. In its Working Paper of September 2001 (http://www.bis.org/publ/bcbs_wp8.pdf), the Basel Committee listed various loss event types. This Working Paper refers to loss event types such as cheque kiting, forgery, breach of privacy, aggressive sales, account churning, product defects, disputes over advisory activities, etc, which are not relevant to CCPs. The broader categories do have application to CCPs, such as theft and fraud, systems security, disasters and other events, trade counterparties and monitoring and reporting issues, but the loss experience will be quite different in a CCP owing to the different nature of the businesses. Furthermore, we observe that the types of events which have given rise to actual reported large operational risk-based losses for banks – such as the mis-selling losses sustained by Lloyds Banking Group, or the rogue-trader problems of various banks – are of a description which cannot arise in a CCP.

10. The 2001 Basel Committee Working Paper stated that the Committee originally suggested using an "alpha" of 30% for the Basic Indicator Approach, to assess the possible future level of operational risk regulatory capital. In light of analysis of the relationship between gross income and capital, a range of 17-20% of gross income was proposed as being sufficient for the purposes of the Basic Indicator Approach. This conclusion was reached after a quantitative impact study on proxies for loss data that was based on limited information on actual operational risk losses. The overall calibration level of 12% for the minimum regulatory capital was deemed a

reasonable cushion to produce required capital in line with the operational risks actually faced by large, complex banking organisations.

11. The qualitative difference between operational risks in a CCP and those in a bank suggest that the quantification of capital requirements for operational risks should also be approached with caution. There is little foundation in the Basel Committee's work to show that it would be appropriate to equate the operational risks of CCPs to the actual loss experience of banks, or, more specifically, to adopt the same metric for operational risk regulatory capital in relation to the types of risk which CCPs (as opposed to banks) face.

12. We also have concerns about the principle of the multiple of gross income as a robust measure of operational risk. In this regard, we note that operational risk is described in paragraph 3.31 of the CPSS-IOSCO Recommendations for Central Counterparties of November 2004 (http://www.bis.org/publ/cpss64.htm) as the risk relating to the functioning of both personnel and systems. The Paper describes typical safeguards against operational risk, including a CCP's business continuity plan, training and supervision programmes, the review of internal control procedures and safeguards to address the availability, connectivity and capacity of a CCP's computer, communication and power systems and data-feeds. The Principles for Financial Market Infrastructures also reflect these recommendations. Bearing this in mind, we believe it is difficult to see why a multiple of the three-year average of the gross income of a CCP is appropriately sensitive for calculating the operational risk a CCP faces.

13. Article 12 of EMIR states that the capital requirement imposed on CCPs to cover operational risks should be proportionate to the risk. Furthermore, any capital charge for operational risk should be calibrated to prevent double counting with other risk charges.

14. In this respect, we would make the following remarks:

    - EuroCCP started clearing in 2008, immediately before the failure of Lehman Brothers. In that period of high market stress following the Lehman failure and the period of high market volatility during the European sovereign debt crisis in 2011 EuroCCP continued to process and clear trades without experiencing operational losses.

    - We strongly believe that the 12%, 15% or 18% measures applicable to banks are likely to be a significant overstatement of the capital requirements needed to ensure that a CCP survives an operational risk event.

    - We do not consider that it will be meaningful for the EBA to draw conclusions from operational risk data provided by CCPs as part of the Discussion Paper assessment, since no uniform reporting or data-capture methodology has been suggested, and different CCPs have widely differing product types and range of clearing activities. The EBA is in danger of comparing very different things in considering any quantitative information supplied.

We suggest that a quantitative impact study (QIS) is necessary to determine the right method for determining a CCP's capital requirement for operational risk.

15. We note that the EBA have asked respondents to provide information on operational risk. We support that concept, as we believe it to be the correct approach in principle to the problem. However, given the short time available for this response, we have not been able to gather relevant information. Furthermore, without a consistent methodology for data capture, we doubt if the EBA could draw meaningful conclusions from data supplied by different CCPs in this timeframe. A fuller QIS would, however, not give rise to those objections.

16. Accordingly, we recommend that the EBA approach the issues as follows:

- For a period of 12 months, to allow for a proper QIS, it may be sensible to employ a proxy measure for non-counterparty risk.

- The multipliers of 12%-18% applied to banks using the Standardised Approach should ***not*** be adopted by the EBA for CCPs.

- Given the much lower risk profile of CCPs, a 5% multiplier for this interim period may be appropriate.

- After the conclusion of the QIS, the EBA should propose a new approach specifically tailored to CCPs. This might follow the proxy approach used by banks not adopting advanced measurement approach, or it might include a sliding scale which allows CCPs with proven track records in managing operational risks effectively to have lower capital requirements.

EuroCCP appreciates the opportunity to comment on the Discussion 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 truly

Diana Chan

Diana Chan
Chief Executive Officer

ANNEX: RESPONSES TO EBA QUESTIONS

Question Number	Response
1.	Yes in general
2.	See paragraph 6
3.	See paragraph 6
4.	See paragraph 6
5.	IAS 7 does not appear adequate as it does not seem to reflect the business profiles of CCPs or the risk and cost issues associated with winding-down or transfer of operations
6.	This issue should be covered in a fuller QIS
7.	No, see paragraphs 7 - 16
8.	We have not been able to respond to this in the time available
9.	No, see paragraphs 7 - 16
10.	See paragraphs 7 - 16
11.	We do not consider that the business lines devised for banks are relevant to CCPs
12.	While this might be feasible in some cases, we doubt it would be practicable for smaller CCPs
13.	See paragraph 16
14.	We have not been able to respond to this in the time available
15.	We do not believe it is necessary to apply the banking framework to calculate a CCP's capital requirements as the framework does not appear appropriate to the operational risks a CCP faces as opposed to those faced by a bank
16-27.	We have not been able to respond to these questions in the time available