



**EBA AND ESMA REPORT ON THE FUNCTIONING  
OF THE REGULATION (EU) NO 575/2013 (CRR)  
WITH THE RELATED OBLIGATIONS UNDER  
REGULATION (EU) NO 648/2012 (EMIR)**

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**EBA**

EUROPEAN  
BANKING  
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European Securities and  
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# Abbreviations

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<b>CCP</b>	central counterparty
<b>CCR</b>	counterparty credit risk
<b>CM</b>	clearing member
<b>MPoR</b>	margin period of risk
<b>EAD</b>	exposure at default
<b>IM</b>	initial margin
<b>NSFR</b>	net stable funding requirements
<b>LR</b>	leverage ratio
<b>LCR</b>	liquidity coverage ratio



## Executive summary

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This report provides the main conclusions from the analysis of the joint functioning of the Capital Requirements Regulation (EU) No 575/2013 (CRR) with the Regulation (EU) No 648/2012 (EMIR).

As requested in the mandate, the European Banking Authority (EBA), together with the European Securities and Markets Authority (ESMA), has focused in particular on those institutions operating as CCPs, and have assessed any potential duplication of requirements for derivative transactions with the ultimate goal of avoiding regulatory risks, as well as undue increased monitoring costs for competent authorities.

After the review of the issues, the EBA and ESMA would recommend that the Commission clarify the overlap of the capital requirements for CCPs holding a banking licence, as well as clarify the wording of Article 305.

The legal basis of this report is in Article 515 paragraph 1 of the CRR, which requires that: 'By 2 January 2015, EBA, together with ESMA, shall report on the functioning of this Regulation with the related obligations under Regulation (EU) No 648/2012 and in particular with regard to institutions operating a CCP, in order to avoid duplication of requirements for derivative transactions and thereby avoid increased regulatory risk and increased costs for monitoring by competent authorities.'



# 1. Introduction

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1. In accordance with Article 515(1) of the CRR, the EBA, together with the ESMA, is required to report on the functioning of this Regulation with the related obligations under the EMIR, in particular with regard to institutions operating as CCPs. Special emphasis should be given to the potential duplication of requirements for derivative transactions, in order to avoid increased regulatory risk and monitoring costs for competent authorities.
2. In line with the mandate of Article 515(1), the EBA and ESMA have focused mainly on those institutions that operate as CCPs, which are also subject to the CRR. Obviously, CCPs are not the only subjects regulated by the CRR and EMIR; this is why the analysis in this report has taken into consideration aspects related to CMs and clients, which are, in many cases, banks.
3. According to the EMIR definition, a CCP is a 'legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer'. This activity is commonly referred to as 'clearing', defined in the EMIR as 'the process of establishing positions, including the calculation of net obligations, and ensuring that financial instruments, cash, or both, are available to secure the exposures arising from those positions'. In Europe, there are currently 17 authorised CCPs.<sup>1</sup>
4. A credit institution is defined in the CRR as 'an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account'. The CRR definition allows a whole range of activities that banks can exercise. There are many different models that are applied by banks and, not surprisingly, banks can indeed also be CCPs. However, it should be noted that only three out of the many thousands of banks in Europe are licensed as CCPs.<sup>2</sup>
5. The EMIR does not prevent Member States from adopting an authorisation as a credit institution for CCPs established in their jurisdiction (Article 14(5)). Should a CCP also be licensed as a bank, the requirements of both the CRR and EMIR would, from a legal perspective, apply to the 'bank-CCP'. Given the nature of CCPs, this report considers whether this leads to duplicative requirements of the CCPs. The EBA and ESMA have in the past been highly aware of this issue. For instance, the EBA technical standard, developed in consultation with the ESMA, set out capital requirements that are mindful of this issue, as illustrated later in this report.

<sup>1</sup> See [https://www.esma.europa.eu/sites/default/files/library/ccps\\_authorized\\_under\\_emir.pdf](https://www.esma.europa.eu/sites/default/files/library/ccps_authorized_under_emir.pdf). At the time of this report, no other CCP was in the process of getting a banking licence in Europe.

<sup>2</sup> Eurex Clearing AG, LCH Clearent SA and European Commodity Clearing AG.



## 2. Analysis of potential duplicative requirements

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6. The report presented by the EBA and ESMA provides an analysis, and, if necessary, recommendations on the main potential duplicative requirements identified. The report does not, however, provide a comprehensive review of CRR and EMIR provisions, and instead focuses on the following items, which, in the view of the EBA and ESMA, can be considered as potentially duplicative or inconsistent requirements among the CRR and EMIR:
- a. capital requirements for CCPs holding a banking licence
  - b. LR, NSFR and LCR
  - c. large exposure requirements in the CRR
  - d. the difference in MPoR application across the two regulations – Article 304 of the CRR and Article 41 of the EMIR
  - e. exposures to CCPs
7. The issues have been identified based on the experiences of supervisors and regulators, but have also been subject to feedback from industry participants during the development of the report.<sup>3</sup> The report therefore provides an accurate overview of the main issues related to potential overlaps between the CRR and EMIR. The following sections describe the issues identified in the five areas in more detail.

### 2.1 Capital requirements for CCPs holding a banking licence

#### Background

8. The EMIR defines a CCP as a ‘legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer’.
9. Whereas the CRR establishes requirements for bank-like activities, the EMIR sets out requirements for CCPs to cover the risks embedded in those clearing-related activities. Basically, banks must allocate their capital resources to meet the capital requirements, while CCPs use collateral from their members and clients in the form of margins and default funds contributions.

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<sup>3</sup> The meeting took place in Paris, on 15 September 2016, with participants from Eurex Clearing, LCH Clearnet SA, and the ISDA. The invited CCPs are the most active participants in the market of clearing that also hold a banking licence. The ISDA was invited to provide the perspective of credit institutions, especially those active as either CMs or clients of CCPs.



10. For example, in the case of a bank, an over-the-counter (OTC) derivative may be bought for a variety of reasons; for example, it may work as a hedge for a particular position in its balance sheet, or might have been taken with the intent of benefiting from market movements. This new position for the bank involves a series of risks (market risk and CCR) for which the bank must allocate the proper quantity of own funds requirement as capital.
11. This is different for CCPs as the same position is held only to mitigate the CCR of the counterparties of the trade. Since the CCP will also hold an opposite derivative position with a different counterparty, this essentially cancels out the market risk of the position, leaving the CCPs exposed only to CCR. To address this risk, for the CCP, but also for the counterparties of the trade, the EMIR applies a different set of protection measures, mainly margins (variation and initial), but also default fund contributions, which are basically funds provided by the counterparties of the CCPs.
12. In this regard, the EMIR and its Delegated Regulations define the requirements that CCPs shall fulfil, including, of course, capital requirements, in order to appropriately mitigate the risk, especially the potential systemic risk caused by the disruption of this clearing activity. Article 16 of the EMIR clearly states that a CCP's capital shall be an adequate protection of the CCP against credit, counterparty, market, operational, legal and business risks that are not already covered by specific financial resources as referred to in Articles 41 to 44 of the EMIR. As noted above, those specific financial resources are basically margins and default funds contributions.
13. Furthermore, the Delegated Regulation (EU) No 152/2013 on capital requirements for CCPs,<sup>4</sup> drafted by the EBA, clearly distinguishes the risks arising from the novation act from other risks carried by the CCP in its usual business conduct.<sup>5</sup> Given that, to a great extent, risks stemming from clearing activities are covered by specific financial resources, capital requirements should ensure that a CCP is at all times adequately capitalised against credit risks, counterparty risks, market risks, operational risks, legal and business risks that are not already covered by those specific financial resources, and that the amount of capital should be enough to allow an orderly winding down or restructuring of its operations. This ensures stability in the case that it becomes necessary to close the CCP.
14. In addition, Recital 5 of the same Delegated Regulation states that Directive 2006/48/EC and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions<sup>6</sup> are appropriate benchmarks for the purpose of establishing capital requirements to

<sup>4</sup> Capital requirements for credit risk, CCR and market risk that are not already covered by specific financial resources, as referred to in Articles 41 to 44 of the EMIR: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32013R0152>

<sup>5</sup> In Recital 1 it states that, among other matters, prudential requirements for CCPs should ensure that they are safe and sound and comply at all times with the capital requirements.

<sup>6</sup> OJ L177, 30.6.2006, p. 201.



cover credit, counterparty and market risks not covered by specific financial resources, since these requirements are similar to those used by credit institutions or investment firms.

15. Finally, Article 4 of the same Delegated Regulation confirms those provisions, stating the methodology to be used by CCPs in order to compute the capital requirements for market risk, the risk-weighted exposure amounts for credit risk and the risk-weighted exposure amounts for CCR that are not already covered by specific financial resources as referred to in Articles 41 to 44 of the EMIR.

16. On the other hand, the CRR makes no distinction between the risks of central clearing and risks stemming from the other activities carried out by a CCP in its usual business conduct, such as in its standard activity of collateral investment.

### **Financial resources in accordance with Articles 41 to 44 of the EMIR – clearing activities**

17. Accordingly, it is clear that, for any CCP acting under the EMIR with a banking licence, there should not be additional capital requirements under the CRR for risks stemming from normal CCP activities, as these are already covered by specific financial resources, as referred to in Articles 41 to 44 of the EMIR and the EBA technical standard on capital requirements.

18. In this regard, asking for capital requirements under the CRR for risks that, in accordance with the EMIR, are already covered by specific financial resources, such as margins and default funds, could be considered as a source of the duplicative requirement for derivatives transactions.

19. Therefore, to be consistent with what is expected by Article 16 of the EMIR, the EBA and ESMA considered that the risks arising from clearing activities are already covered by the dedicated financial resources held by CCPs for this purpose, and that they should not be covered by further CRR requirements.

### **Capital requirements in accordance with Article 16 of the EMIR**

20. Article 16 of the EMIR states that a CCP's capital shall be an adequate protection of the CCP against credit, counterparty, market, operational, legal and business risks that are not already covered by specific financial resources as referred to in Articles 41 to 44 of the EMIR.

21. Delegated Regulation (EU) No 152/2013 further defines how CCPs, with or without a banking licence, should compute the capital requirements for winding down or restructuring (Article 2), for operational and legal risk (Article 3), for credit risk, CCR and market risk (Article 4), and for business risk (Article 5).



22. For the risk directly covered by those Articles of Delegated Regulation (EU) No 152/2013, no duplicative capital requirements are detected with those of the CRR. However, Delegated Regulation (EU) No 152/2013 does not provide all approaches that can be used under the CRR for the calculation of capital requirements.
23. The capital requirements for investment firms and credit institutions were deemed to be an appropriate benchmark for the purpose of establishing capital requirements to cover credit, counterparty credit and market risks of CCPs. Therefore, Article 4 directly recalls the requirements of the CRR by referencing the respective Articles. However, CCPs are only allowed to use the standardised approaches of the CRR, and not the internal-model approaches.
24. The restrictions to use solely the standardised approach for credit risk (Article 4 paragraph 3) and the mark-to-market method for CCR (Article 4 paragraph 4) are also valid for CCPs holding a banking licence, which are subject to the CRR, while the internal-model approach is available for other financial institutions.

### **CRR – Pillar 2 requirements**

25. Finally, CRD IV provides the possibility for competent authorities to apply – via Pillar 2 – additional capital requirements to ensure that an appropriate capital charge is applied to all the risks not covered by Article 1 of the CRR. This should not be interpreted as duplicative for CCPs holding a banking licence, and so subject to the CRR, but more of a deficiency of the EMIR framework for CCPs. In its opinion to the Commission,<sup>7</sup> the EBA proposed the introduction, for CCPs, of an approach similar to the Pillar 2 for credit institutions. This would be to give authorities the possibility of accounting for the individual situation of a CCP by applying additional capital requirements to cover risks to which the CCP is or might be exposed and that are not addressed, or are not fully addressed, by the current capital requirements.

### **Capital requirements for interoperability arrangements**

26. Article 2 of the EMIR defines an interoperability arrangement as ‘an arrangement between two or more CCPs that involves a cross-system execution of transactions’. Assessments of interoperability arrangements can be found in the ESMA reports on extension of the scope of interoperability arrangements<sup>8</sup> and on the possible systemic risk and cost implications of interoperability arrangements,<sup>9</sup> as well as in

<sup>7</sup> EBA/Op/2012/02.

<sup>8</sup> See [https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-1067\\_-\\_report\\_on\\_io\\_extension\\_0.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-1067_-_report_on_io_extension_0.pdf)

<sup>9</sup> See <https://www.esma.europa.eu/press-news/esma-news/esma-issues-report-risks-and-costs-ccp-interoperability>



the ESRB report to the Commission on the systemic risk implications of CCP interoperability arrangements.<sup>10</sup>

27. Quoting from the ESMA report: ‘the primary aim of links between market infrastructures, including interoperability arrangements, was to open markets to competition, at trading and clearing level, and add new trading and clearing actors on top of the existing ones. Interoperability allows a CCP to have access to a trade flow without fragmenting the liquidity; any trade coming from a trading venue can be cleared either through one CCP, when the relevant clearing members belong to the same CCP or, through the interoperable link when the relevant clearing members belong to each of the interoperable CCPs. [...] Allowing clearing members to access a larger number of CCPs via interoperable links, gives a greater scope of multilateral netting than if the CCPs were unlinked. The lower the number of CCPs that a single CM needs to access, the higher the degree of netting, thereby the lower the aggregate credit risk (and, as a result, the lower the demand for collateral).’
28. In line with what has been already outlined above in the background part of this section, once margins are regularly used to protect against risks due to cross-system execution between one CCP and another CCP, the EMIR does not have additional capital requirements for those CCPs.
29. This is clearly stated in Recital 6 of Delegated Regulation (EU) No 152/2013, which explains that a CCP does not have to hold capital for trade exposures and default fund contributions that arise under an interoperability arrangement where the requirements of Articles 52 and 53 of the EMIR are fulfilled. It should be noted that the interoperability arrangement compliance is based on procedural requirements and exchange of margins and does not take into consideration additional capital requirements for CCPs.
30. In addition, Article 4 of Delegated Regulation (EU) No 152/2013 clearly states that, where all the conditions referred to in Articles 52 and 53 of the EMIR are not fulfilled, and where a CCP does not use its own resources, the CCP shall apply a risk weight of 1.250 per cent to its exposure, stemming from contributions to the default fund of another CCP, and a risk weight of 2 per cent to its trade exposures with another CCP.<sup>11</sup>
31. Regarding the capital requirement for clearing activities under the CRR, the risks of central clearing activities carried out by a CCP in its usual business conduct, such as in their standard interoperability activity, are not defined. According to the CCR scope

<sup>10</sup> See [http://www.esrb.europa.eu/pub/pdf/other/2016-01-14\\_Interoperability\\_report.pdf](http://www.esrb.europa.eu/pub/pdf/other/2016-01-14_Interoperability_report.pdf)

<sup>11</sup> Conversely, when an interoperability arrangement fulfils the requirements of Articles 52 and 53 of the EMIR, the CCP does not have to respect a capital requirement under the EMIR against the risk arising from this interoperability arrangement.



of application, central clearing activities, such as interoperability activities, if carried out by an ordinary bank, would generate exposure for CCR.

32. It would consequently appear duplicative and inconsistent to exempt, under one regulation (the EMIR), some activities from capital requirements because they are already covered by specific financial resources (margins) and operational procedure requirements (Articles 52 to 53 of the EMIR) and simultaneously ask for capital requirements for the same activity under another regulation (the CRR).
33. Accordingly, with respect to the mandate in Article 515(1), it should be clarified that, for CCPs with a banking licence acting under the EMIR, where the clearing activities encompass activities with other CCPs for which an interoperability arrangement in compliance with Articles 52 to 53 of the EMIR has been established, the applicable regulation is established in Article 4(5) of Regulation (EU) No 152/2013. Accordingly, these activities shall not be subject to any capital requirements under the CRR.

## Conclusion and proposal

34. Although EMIR and CRR capital requirements seem to be redundant for CCPs holding a banking licence, because for some aspects the EMIR requirement is more stringent and conservative, they are in fact based on different definitions of capital and take into account different risks for specific purposes. This is the reason why CCPs holding a banking licence should be subject to both capital requirements as a matter of principle, with some exemptions when they are properly justified.<sup>12</sup>
35. With respect to credit risk, market risk and CCR related to clearing activity, they would already be covered by the specific financial resources requested under Articles 41 to 44 of the EMIR. Therefore, to avoid any confusion that might lead to unintended duplication of requirements for derivative transactions, the EBA and ESMA propose to clarify explicitly in the CRR that points a) to d) and point f) of Article 92(3) of the CRR are limited to the credit risk, market risk and CCR that are not already covered by specific financial resources as referred to in Articles 41 to 44 of the EMIR.
36. Similarly, for CCP exposures held by CCPs with a banking licence for which an interoperability arrangement has been established, in compliance with Articles 52 to 53 of the EMIR, the EBA and ESMA recommend the Commission to clarify explicitly, in the context of the review of the CRR or EMIR, that Articles 300 to 309 of the CRR are not applicable to CCPs with a banking licence.

<sup>12</sup> With respect to capital, EMIR requirements are applicable to capital as it is defined in Article 2(25) of the EMIR, while CRR requirements are applicable on both the common equity Tier 1 capital, and the own funds as they are defined in Part Two of the CRR.



## 2.2 Leverage and liquidity for CCPs

### LR application to CCPs and CMs

37. For CCPs holding a banking licence, due to the inherently low-risk but high-volume nature of the clearing business, the application of the LR is problematic, since the application of a binding LR would constrain the clearing activity.

38. This topic has already been reviewed in the 'EBA Report on the Leverage Ratio Requirements under Article 511 of the CRR'.<sup>13</sup> In the LR report, the EBA acknowledges the issues related to LR application to CCPs. In particular, policy Recommendation 3<sup>14</sup> in the report suggests an exception from an LR requirement for CCPs holding a banking licence.

39. As regards the LR application for CMs, the recent proposals published by the European Commission<sup>15</sup> have already considered this aspect and introduced an exemption for margins posted by clients to CMs. Nonetheless, ESMA and the EBA would like to highlight its considerations in this regard.

40. The ESMA believes that, with respect to clearing services offered by CMs, it has been stressed (e.g. in the ESMA final report on the clearing obligation for financial counterparties with a limited volume of activity<sup>16</sup>) that the current LR framework is negatively affecting client clearing offering. This is, therefore, conflicting with one of the key measures of the EMIR, stemming from the G20 commitments made in Pittsburgh in 2009, the clearing obligation.

41. In the view of the ESMA, one way to mitigate this effect, without compromising the objectives of the LR, would be to recognise margins posted by clients to CMs as risk mitigants. ESMA considers that the LR requirements should not be set in a manner that conflicts with the clearing obligation under the EMIR. As a result, ESMA welcomes the Commission's proposed amendments to the CRR<sup>17</sup>.

42. On the other hand, the EBA in its Report on the Leverage Ratio notes that: 'The BCBS is considering this issue carefully and seeking further evidence on the potential

<sup>13</sup> See <https://www.eba.europa.eu/documents/10180/1360107/EBA-Op-2016-13+%28Leverage+ratio+report%29.pdf>

<sup>14</sup> Recommendation 3: 'As a derogation to the general principle of recommendation 1, CCPs, as defined and regulated through Regulation (EU) No 648/2012 (EMIR) and in particular when holding a banking licence and thus being captured by the CRR requirements, should be exempted from an LR requirement.'

<sup>15</sup> See [http://ec.europa.eu/finance/bank/regcapital/crr-crd-review/index\\_en.htm](http://ec.europa.eu/finance/bank/regcapital/crr-crd-review/index_en.htm).

<sup>16</sup> The final report on the clearing obligation of financial counterparties with a limited volume of activity is available at the following link: [https://www.esma.europa.eu/sites/default/files/library/2016-1565\\_final\\_report\\_on\\_clearing\\_obligation.pdf](https://www.esma.europa.eu/sites/default/files/library/2016-1565_final_report_on_clearing_obligation.pdf)

<sup>17</sup> See the 23 November 2016 publication: [http://ec.europa.eu/finance/bank/docs/regcapital/crr-crd-review/161123-proposal-amending-regulation\\_en.pdf](http://ec.europa.eu/finance/bank/docs/regcapital/crr-crd-review/161123-proposal-amending-regulation_en.pdf) 'In order not to dis-incentivise client clearing by institutions, institutions are allowed to reduce the exposure measure by the initial margin received from clients for derivatives cleared through QCCPs (Article 429c(4)).'



impact of the Basel III LR on clearing members' business models during the consultation period. At this stage, it is too early to draw firm conclusions in this regard.' The EBA continues to maintain this view – namely that it is premature to draw conclusions here and international consistency should be sought, taking into account the global nature of CCP clearing, before making final conclusions on the matter.

### Liquidity – NSFR and LCR

43. Regarding liquidity requirements and, more specifically, the NSFR, this topic has already been reviewed in the EBA Report on 'Net Stable Funding Requirements under Article 510 of the CRR'<sup>18</sup>. In particular, policy Recommendation 7<sup>19</sup> suggests an exception from the NSFR requirement for CCPs holding a banking licence, which do not perform maturity transformation. For this reason, the topic does not need to be further developed in this report.
44. The short-term liquidity requirements in the CRR related to the LCR have also been analysed already by the EBA in 2013<sup>20</sup> in the 'Report on Impact Assessment for Liquidity Measures under Article 509(1) of the CRR'. In this LCR report, the LCR reported by the CCPs is shown to be largely compliant with the threshold set in the CRR, and no evidence was detected of difficulties in meeting the LCR requirements, essentially because, in general, CCPs dispose of relevant stocks of high-quality assets.<sup>21</sup> For these reasons, no specific recommendations were suggested in the EBA monitoring report.
45. Even so, it could be argued that the LCR is not specifically designed to measure liquidity issues for CCPs. For instance, the LCR requires banks to estimate the amount of variation margin that might be called in the next 30 days by each of their counterparties on their portfolio of derivatives under stressed market conditions. The CRR rule requires computing the sum of those amounts as potential outflows in the LCR. It seems incongruous for CCPs to apply this methodology for stressed outflows, since the sum of total variation margin posted and collected by CCPs towards their CMs is equal to zero by definition, as long as CMs do not default.
46. It is safe to say that liquidity is one of the most important issues for any CCP. This is why the liquidity risk stemming from clearing activities is covered by specific EMIR

<sup>18</sup> See <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-22+NSFR+Report.pdf>

<sup>19</sup> 'Recommendation 7: As long as CCPs' activity (CCPs having banking licence) is focused on acting purely as mediators between counterparties without incurring the specific type of banking maturity transformation risk that the NSFR is designed to capture, CCPs could be exempted from the net stable funding requirement.'

<sup>20</sup> <https://www.eba.europa.eu/documents/10180/16145/EBA+BS+2013+415+Report+regarding+LCR+impact.pdf>

<sup>21</sup> 'CRs of mortgage banks and building societies (Group 6) as well as of CCPs, securities trading houses, and custodian institutions (Group 7) are relatively high. The first type of business model benefits from a lower liquidity gap as it predominantly manages its liquidity risk by limiting maturity mismatch between asset and liability. The second type of business model enjoys a solid portfolio of HQLA.'



requirements. In particular, Article 44 of the EMIR requires CCPs to control their liquidity risk, and Delegated Regulation (EU) No 153/2013 specifies the framework that CCPs have to set up for managing their liquidity risk.

47. In practice, the liquidity constraints for CCPs in the EMIR are fairly stringent in terms of the frequency (daily monitoring) and stress to be applied ('Cover 2' rule in Articles 44 and 47 of the EMIR).

48. Also, it could be argued that the CRR requirements regarding short-term liquidity are largely compatible with the EMIR requirements. For instance, the monthly LCR monitoring frequency is not irreconcilable with the daily EMIR monitoring, and the high-quality assets eligible for the CRR are also acceptable from the EMIR perspective.

## Conclusion

49. In conclusion, for what relates to the LR and the NSFR, the EBA has already given its view in two separate reports and believes that an exemption would be appropriate for CCPs. In addition, the ESMA has also expressed its concerns about the impact of the current LR framework on the clearing obligation, and considers that the LR framework should be finalised in a manner that does not conflict with the clearing obligation under the EMIR. The EBA, on the other hand, considers that, as international consistency remains a key concern on this issue, it is important to wait till conclusions have been reached at the international table.

50. Regarding the LCR, the EBA and ESMA acknowledge that the EMIR includes stringent requirements for CCPs' liquidity, and that the CRR framework for short-term liquidity application for CCPs holding a banking licence cannot be considered duplicative, although they are likely to be less meaningful in the context of CCPs. For these reasons, no specific proposal is formulated here for the LCR.

## 2.3 Large exposures

### Background

51. As part of this review, the EBA and ESMA also assessed whether there might be issues with the large exposure requirements included in Articles 387 to 406 of the CRR for those CCPs holding a banking licence.

52. Article 395(1) of the CRR states that an institution shall not incur an exposure, after taking into account the effect of the credit risk mitigation in accordance with Articles 399 to 403, to a client or group of connected clients, of a value that exceeds



25 per cent of its eligible capital. Where that client is an institution, or where a group of connected clients includes one or more institutions, that value shall not exceed 25 per cent of the institution's eligible capital, or EUR 150 million, whichever is highest.

53. These large exposure requirements would generally constrain deposits of a CCP to a commercial bank;<sup>22</sup> this is because a CCP receives significant amounts of pre-funded resources (for example, intraday margin calls) and is required to maintain at least 95 per cent of their cash with highly liquid secured collateralisation on an overnight basis when such cash is deposited through commercial banks.<sup>23</sup> Accordingly, it is clear that CCPs could easily exceed the limit of 25 per cent of own funds, or EUR 150 million. For this reason, it would have been necessary to assess whether CCPs holding a banking licence could face a challenge to find a sufficiently high number of commercial banks in which to deposit these resources – particularly in those countries where access to central banks may not be possible.

54. However, because of the explicit exemption in Article 390(6c) of the CRR, it should be noted that the large exposure requirements do not currently pose any limitation to a CCP's activity. Furthermore, along with many other topics of the CRR, the large exposure framework at this stage is under review by the Commission. For this reason, the issue is not further developed in this report.

## Conclusion

55. Due to the explicit exemption in Article 390(6c) of the CRR, this issue is not currently relevant for CCPs holding a banking licence. Should the framework change in the future, the EBA and ESMA may have to reconsider the issue.

## 2.4 Difference in MPoR application

### Background

56. In this section, the focus of the analysis moves to the requirements that apply to all CCPs and to all CMs subject to the CRR. Specifically, the focus in this section is the application of the MPoR in Article 304 of the CRR compared with the liquidation periods (which are conceptually similar to the MPoR) of Article 41 of the EMIR.

<sup>22</sup> A CCP without a banking licence, however, does not face absolute limitations in this regard. Article 47 of the EMIR and Article 45 of RTS 153/2013 lay down qualitative requirements with regard to concentration limits, but do not set numerical limits.

<sup>23</sup> Article 45 of Delegated Regulation (EU) No 153/2013.



57. Article 26 of Delegated Regulation (EU) 153/2013<sup>24</sup> (as mandated by Article 41 of the EMIR) compared to Article 1(2) of the Delegated Regulation (EU) 585/2015<sup>25</sup> (as mandated by Article 304(5) of the CRR) may seem like an inconsistency due to a different treatment for the same instrument. The liquidation period applied to the CM exposure with a CCP, for financial instruments other than OTC derivatives, is shorter (i.e. it could be one day in some circumstances or two days) than the MPoR applied to the exposures of the CM to its clients (at least five days), even if the financial instrument exchanged by the CM is the same with respect to the client or the CCP.

58. Therefore, taking the MPoR under the EMIR and the MPoR under the CRR out of context, one may conclude that the two regulations are inconsistent. However, it is worth elaborating on the respective use of the MPoR under the two regulations with regard to their objectives and different types of calculations. When the two concepts are put into context, the apparent inconsistency no longer stands.

59. Under the CRR, the MPoR represents only one of the parameters used in the calculation of the CCR exposure to determine the level of capital. Under the EMIR, the MPoR is used to determine margin requirements. Therefore, the whole architecture of the models and the associated parameters between CCPs and CMs are different. The difference is based on many elements, such as the methodology, the choice of risk factors or the volatility structure. Therefore, the simple use of the same time horizon does not guarantee a consistent computation of the EAD.

60. As a result, in isolation, the respective MPoR of the CRR and the EMIR may appear inconsistent; however, they are in fact different concepts. As such, it is not relevant to compare them as if they were the same parameter.

## Conclusion

61. Following the argument written above, in the background subsection, the EBA and ESMA do not consider the difference between the liquidation period of Article 41 of the EMIR and the MPoR application of Article 304 of the CRR to be fully comparable, and so do not consider them to be inconsistent.

62. For these reasons, the EBA and ESMA do not suggest any change to the MPoR in Article 304(3–4) concerning the treatment of CMs' exposure to clients.

<sup>24</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:052:0041:0074:en:PDF>

<sup>25</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32015R0585>



## 2.5 Clients' exposures to CMs

### Background

63. This section provides a comparison between the treatment of clients' exposure to CMs in the CRR framework and in the EMIR, assessing the consistency of the two regulations.

64. Article 305<sup>26</sup> of the CRR regulates the treatment of the clients' exposures to the CMs. Notably, in paragraph 2 of that Article, four conditions are specified in order to apply the two per cent risk weight. These four conditions on the exposure can be summarised as follows: a) segregation<sup>27</sup> b) portability<sup>28</sup> c) independent legal opinion<sup>29</sup> and d) qualified CCP.<sup>30</sup>

65. Furthermore, in paragraph 3 of Article 305, it is stated that 'without prejudice to the conditions specified in paragraph 2, where an institution that is a client is not protected from losses in the case that the CM and another client of the CM jointly default, but all the other conditions set out in paragraph 2 are met, the client may calculate the own funds requirements for its trade exposures for CCP-related transactions with its CM in accordance with Article 306, subject to replacing the 2 per cent risk weight in paragraph 1(a) of that Article with a 4 per cent risk weight'.

66. Regarding the treatment of segregation and portability in the EMIR, they are regulated in Article 39. These EMIR requirements have been thoroughly assessed in the report published by the ESMA on 13 August 2015 on the 'Review of the Segregation and Portability Requirements (2015/1253)'.<sup>31</sup> In accordance with Section 3.2 of this report, all EU CCPs offer at least three types of accounts: (i) house

<sup>26</sup> (Part Three, Title II, Chapter 6, Section 9)

<https://www.eba.europa.eu/regulation-and-policy/single-rulebook/interactive-single-rulebook/-/interactive-single-rulebook/article-id/2016>

<sup>27</sup> (a) The positions and assets of that institution related to those transactions are distinguished and segregated, at the level of both the CM and the CCP, from the positions and assets of both the CM and the other clients of that CM and, as a result of that distinction and segregation, those positions and assets are bankruptcy remote in the event of the default or insolvency of the CM or one or more of its other clients.

<sup>28</sup> (b) Laws, regulations, rules and contractual arrangements applicable to or binding that institution or the CCP facilitate the transfer of the client's positions relating to those contracts and transactions and of the corresponding collateral to another CM within the applicable MPoR in the event of default or insolvency of the original CM. In such a circumstance, the client's position and the collateral shall be transferred at market value, unless the client requests to close out the position at market value.

<sup>29</sup> (c) The institution has available an independent, written and reasoned legal opinion that concludes that, in the event of legal challenge, the relevant courts and administrative authorities would find that the client would bear no losses on account of the insolvency of its CM or of any of its CM's clients under the laws of the jurisdiction of the institution, its CM and the CCP; the law governing the transactions and contracts that the institution clears through the CCP; the law governing the collateral; and the law governing any contract or agreement necessary to meet the condition in point (b).

<sup>30</sup> (d) The CCP is a QCCP.

<sup>31</sup> [https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1253\\_-\\_emir\\_review\\_report\\_no.3\\_on\\_segregation\\_and\\_portability.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1253_-_emir_review_report_no.3_on_segregation_and_portability.pdf)



account<sup>32</sup> (ii) the individually segregated account (ISA)<sup>33</sup> (iii) the omnibus segregated account (OSA).<sup>34</sup>

67. Furthermore, a number of EU CCPs have implemented other accounts,<sup>35</sup> the most common addition to the EMIR segregation being to offer two types of OSA: net and gross.<sup>36</sup> The ESMA Report concludes that the take up for ISA accounts is minimal.<sup>37</sup>

### Focus on CRR conditions in Article 305

68. In this section, the requirements in Article 305(2) and 305(3) will be further analysed<sup>38</sup> in order to detect the possible issues concerning them.

### Segregation

69. The segregation level of the accounts available to clients is of fundamental importance in order to clarify the different conditions established in Article 305(2) and 305(3), and to apply the correct risk weight (two per cent or four per cent) for CCP-related transactions.

70. The topic of segregation and the correct risk weight application for clients' exposure to CM, in the case of net and gross OSA, has already been considered in the EBA Q&A 2013\_668.<sup>39</sup>

71. This Q&A asked whether the criteria in Article 305(2)(a) is met with gross omnibus segregation solutions which, according to the drafter of the question, would provide the same level of segregation as individual segregation.<sup>40</sup>

72. The EBA answer has already clarified that: 'the CRR clearly requires the use of a clearing account that provides at least an equivalent level of client protection as

<sup>32</sup> Where CMs' positions and assets are recorded.

<sup>33</sup> Where the assets and positions of a single client of the CM can be recorded.

<sup>34</sup> Where the positions and assets of several clients of the CM can be recorded.

<sup>35</sup> Sometimes in response to some specific requests from CMs or clients, due to the global nature of their activities and the interaction of these requirements with other segregation models or requirements from other jurisdictions.

<sup>36</sup> In the net OSA, the positions of all clients are recorded on a net basis. Consequently, the corresponding margins are calculated by the CCP on this net basis. This is the main difference from the gross OSA, where the positions of all clients are recorded on a gross basis, with the corresponding margins calculated on each client position. In practice, with gross OSA, the clients are individually identifiable, even if they do not benefit from the ISA protection.

<sup>37</sup> With no straightforward explanation for this behaviour from the CCPs. Quoting from the report: 'The reasons for this could be a lack of interest, the absence of mandatory clearing obligation, the inadequacy of technical and operational solutions corresponding to the models, the cost of implementation (most probably indirect costs) and of ISA day to day management. On derivatives there are only a few ISAs being taken up by those few clients interested in the potential beneficial capital treatment, but the provisions of the Capital Requirements Regulation (CRR) on qualified CCPs have not come into force yet.'

<sup>38</sup> Aside from the CRR requirement in 305(2)(d) – i.e. the CCP must be a qualified CCP, which seems non-controversial.

<sup>39</sup> [https://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2013\\_668](https://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2013_668)

<sup>40</sup> In the Q&A, the question specifies 'E.g. account segregation with asset-tagging, where good individual asset attribution yields the same results as individual segregation'.



individual client segregation. In order to benefit from the 2% risk weight, the client must not be exposed to risk arising other than from its own positions and assets. Therefore, if the client is exposed to a double default of its clearing member and another client, or to a loss of value of other clients' collateral, then it should not benefit from the 2% weighting.'

73. This answer is important for the purpose of this analysis because it clarifies two aspects of the requirement in Article 305. First of all, even though not directly mentioning the ISA and OSA terminology, because the CRR is more general in this regard, the requirement in Article 305(2) and 305(3) can be related to the different segregation of the accounts available at CCPs. Secondly, the segregation itself is the only requirement that can trigger the different treatment – i.e. two per cent or four per cent risk weight, with the two per cent risk weight available only if the client is exposed to risk stemming from other than its own positions and assets.

74. On the other hand, the four per cent risk weight of Article 305(3) would be applied if the client is exposed to any form of risk arising from its CM or another client's defaults, or from loss in values of other clients' collateral.

75. The EBA and ESMA consider that it is important to clarify which are the segregation conditions that, according to the CRR, allow the application of the standard treatment for non-cleared transactions. Currently, the text of the Article clarifies only the conditions under which the client can adopt the two per cent, leaving a margin of speculation regarding whether the four per cent is always applied to any other segregation condition weaker than complete segregation, or whether there are indeed accounts in the market offered by CCPs with a level of segregation so feeble that a standard treatment for non-cleared transactions would be adopted.

## Porting

76. The second condition established in Article 305(2)(b) relates to the rules and arrangements that facilitate the transfer of the client's position to another CM in the event of default of the original CM. The arrangement in place that facilitates the porting does not necessarily require a guarantee of portability.

77. The EBA and ESMA consider that it should be clarified if an arrangement such as backup CM, or a similar solution, should be adopted by clients too, without relying solely on what CCPs should have done under Article 48(5) and (6) of the EMIR. From the paragraph, it is not clear if it is sufficient that the clients have only 'considered' what they could do regarding porting in the event of insolvency of the CM. Clients should be able to know whether it is enough to show that they have plans in place to attempt to port positions, even if they do not necessarily need to have identified a backup CM.



## Legal opinion

78. The third condition, in accordance with Article 305(2)(c) of the CRR, is that clients wishing to benefit from the preferential capital requirement by looking through their CM exposure to a CCP are required to obtain a legal opinion confirming that the conditions established in that Article are met.
79. The EBA and ESMA consider it important to report that there are law firms that find it challenging to provide such legal opinions because they do not consider the conditions in Article 305 as being legal tests on which they can opine. This results in qualified legal opinions that are unclear.
80. By not being able to obtain a clear legal opinion, CMs' clients who are not members of a CCP cannot look through their CM exposure to a CCP in order to benefit from the lower capital charges. This means that clients need to hold potentially unnecessary additional capital to support their exposure to a CCP, unnecessarily increasing the cost of client and indirect clearing, and ultimately voiding the whole purpose of the Article.
81. Additionally, the meaning in Article 305(2)(c) of the term 'bear no losses' needs to be made clear, as it is currently subject to interpretation. It should be clarified if it refers to the fact that a client will receive the amount which the CCP determines to return to the client following the application of its default procedures. This amount would therefore exclude losses resulting from CCP default or other market, custody, investment, fraud risk or transit risk outside the CM's/client's default, as well as any costs to enforce any pre-agreed security or other insolvency management arrangements.

## Conclusion and proposal

82. The EBA and ESMA consider the four conditions in Article 305 (segregation, portability, legal opinion and qualified CCP) as essential in order to grant a favourable treatment for cleared exposures compared to the standard treatment for non-cleared exposures.
83. However, following the points of view outlined above, the EBA and ESMA also consider that the Article 305 may pose a duplicative requirement for derivative transactions, potentially increasing regulatory risks and monitoring costs for the competent authority due to the unclear wording. The uncertainty linked to the segregation, the portability and the legal opinion requirements could prevent the proper identification of the right capital requirement being applied to clients' exposures.



84. For these reasons, the EBA and ESMA recommend that the Commission clarify the wording in Article 305(2) and 305(3) regarding the segregation, the portability and the legal opinion requirements. The EBA, together with the ESMA, stand ready to prepare a draft suggestion for this Article, should the Commission require it.

### 3. Conclusions

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85. After examining the functioning of the CRR with the related obligations under the EMIR – as required in Article 515(1) of the CRR – the EBA, together with the ESMA, have produced this report.

86. Different issues were examined during the analysis. Not all of the potential issues have been analysed in the report because many of the concerns focused on forthcoming regulatory developments, such as the implementation of the so-called SA-CCR into the CRR, or are even pending international agreement, such as the Basel discussions over LR and NSFR or the recovery and resolution regulation for CCPs. Accordingly, these elements have not been included in the scope of this report.

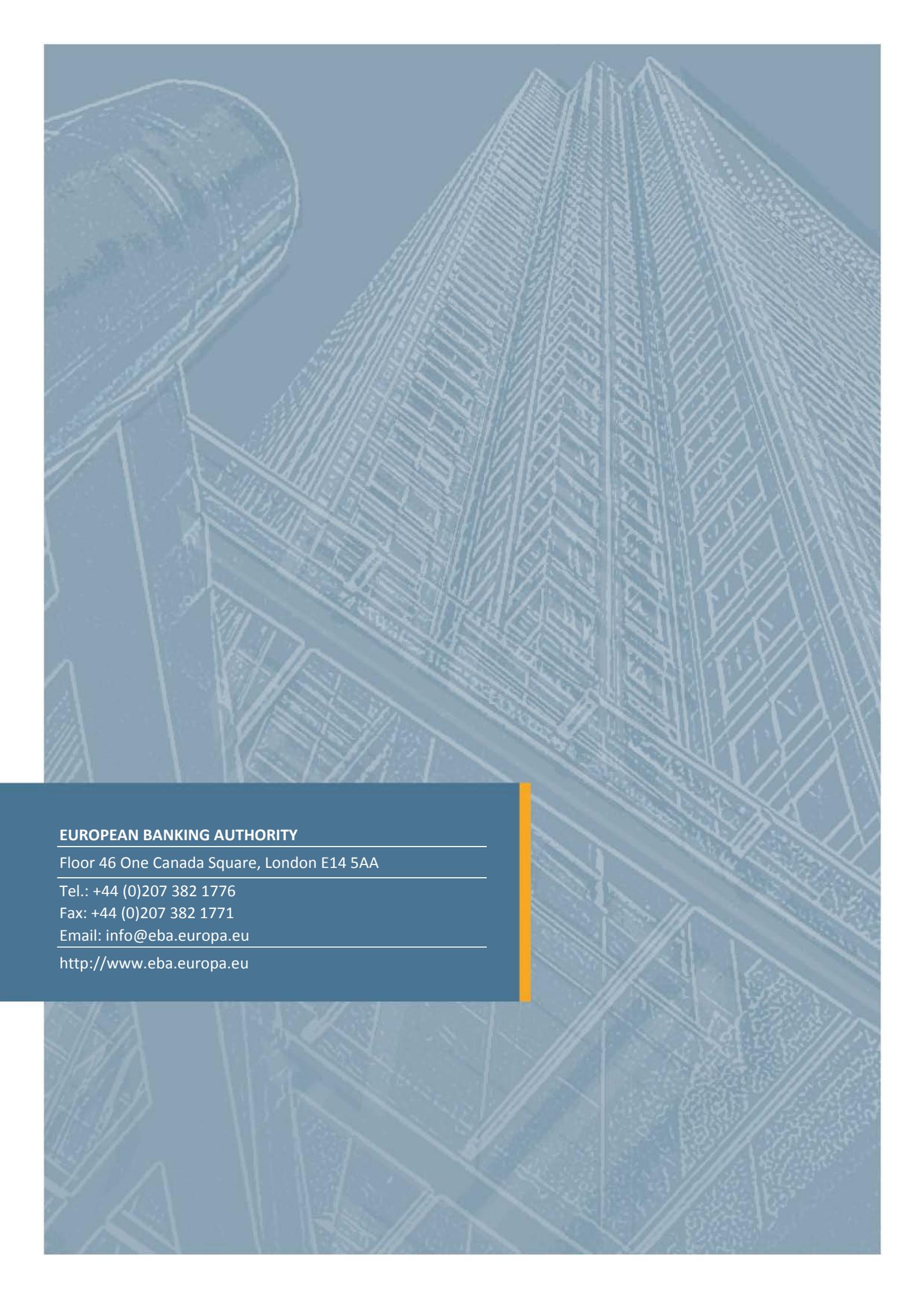
87. As a conclusion of the analysis, the EBA and ESMA recommend that the treatment of CRR capital requirements for exposure already covered by specific financial resources provided by EMIR requirements should be explicitly clarified.

88. According to the EBA and ESMA, CRR application can generate a duplicative requirement for CCPs holding a banking licence, exposure already being covered by specific financial resources, as in Articles 41 to 44 and 52 to 53 of the EMIR.

89. Therefore, the EBA and ESMA invite the Commission to clarify that CCPs holding a banking licence should be exempted from specific points as follows:

- Points a) to d) and point f) of Article 92(3) of the CRR should not be applicable to the credit risk, CCR and market risk for exposures that are already covered by specific financial resources as referred to in Articles 41 to 44 of the EMIR.
- Articles 300 to 309 of the CRR should not be applicable to the exposures to central counterparties with which an interoperability arrangement has been established in compliance with Article 51 to 54 of the EMIR.

90. Finally, the EBA and ESMA recommend that the wording of Article 305 should be clarified in order to allow a consistent application of EMIR and CRR requirements related to clients' accounts, as well as to clarify the requirements around the production of legal opinion, and to avoid excessive and unnecessary capital requirements for clients' exposures to CCPs.



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