April 02, 2012

RESPONSE TO EBA DISCUSSION PAPER ENTITLED "DRAFT REGULATORY TECHNICAL STANDARDS ON THE CAPITAL REQUIRMENTS FOR CCPs UNDER THE DRAFT REGULATION ON OTC DERIVATIVES, CCPs AND TRADE REPOSITORIES"

Overview

EACH, the European Association of Central Counterparty Clearing Houses, welcomes the opportunity to respond to EBA's Discussion Paper on Draft Regulatory Technical Standards on the capital requirements for CCPs under the draft Regulation on OTC derivatives, CCPs and Trade Repositories ("the Discussion Paper"). EACH has contributed to the development of the associated Level 1 text, "EMIR", since its inception and strongly supports its central objective of bringing more business in standardised OTC derivatives within the ambit of CCP clearing as a means of managing systemic and contagion risk.

EACH would like to highlight, that there is a great variety of CCPs, which can also be seen in the diverging compilation of EACH Members. Some CCPs clear only derivatives or equities, other CCPs clear a full product range. This divergence must be reflected in the final Technical Standard. The principle of risk-focused proportionality should be reflected in an adequate manner by defining a capital model with different modules based on business activities as it is also already implemented in the banking framework of CRD. A minority of EACH members are required to have banking authorisation alongside their clearing house status; the majority of EACH members are not authorised as banks.

EACH welcomes that no capital is required to cover the "trade exposure" positions towards the CCP's clearing members including any risk deriving from revaluations of collateral received under EMIR Article 39 and 40 (commonly labelled as "clearing activities" in the discussion paper). Nevertheless EACH understands that additional capital is required against risk arising from investment activities and other non-clearing activities and to mitigate against operational risk arising from all activities of a CCP according to EMIR Article 12.

EACH appreciates the fact, that EBA has considered parts of the CPSS-IOSCO Principles for Financial Markets Infrastructure and the Capital Requirements Directive, in order to avoid conflicting regulation.

EACH notices that under the current proposal a CCP is supposed to hold capital equalling the maximum of either the on-going operational expenses over an adequate time span or the capital calculated according to the "CRD" approach. Under CPSS-IOSCO contrary to that only the first approach is mentioned explicitly in principle 15. However, the key considerations especially considerations 2 and 3 indicate additional requirements. As the key considerations give room for interpretation, EACH sees the risk that a tight EU regulation might. This create a disadvantage for European CCPs in competition with CCPs outside the European Union as these might not face explicit additional requirements

However, should a formal risk-based capital calculation eventually be proposed, EACH believes that the banking framework for calculating capital requirements for operational, credit and market risk is not unreasonable for CCPs and should be appropriately calibrated and proportionate to the operational risks a CCP faces as opposed to those faced by a bank. New and specific requirements would create disadvantages for the minority of CCPs that require a banking license under their local law and would be in line with CPSS-IOSCO key consideration 3.

Please note, that EACH will just answer the general questions, as EACH is unable to answer specific questions (especially Question 23 – Question 27). Nevertheless the individual CCPs will hand in their own responses. Hereby EACH would like to emphasize, the need to deal with the given information (e.g. cost-benefit Analysis) carefully and to outline them as confidential if requested by the individual CCP.

Referring to the questions our main concerns are (in order of the document):

1. Introduction / CPSS-IOSCO Principles for Financial Markets Infrastructure (PFMIs)

Text 8

- EACH welcomes, that EBA aligns the timeframe of the capital held by a CCP in accordance with CPSS-IOSCO, in order to avoid a double or contradicting regulation.

Text 8 & 12

- The methodology for calculating the capital required for orderly restructuring or wind down over the considered time horizon shall be calculated under a variety of business scenarios and updated regularly as well as when material changes occur. This would be subject to a variety of arbitrary assumptions over the development of cost. Usually such assumptions are made under a going concern assumption but those would need to be enhanced by assumptions under a restructuring or wind down assumption which could lead to cost increase or decrease - as new business might not be taken on. EACH proposes to use accounting figures for the calculation of the on-going expenses. EACH further proposes to use – in line with Article 92 of the proposed CRR – "fixed overheads of the [CCP] for the preceding year" and take 1/12 of this as the monthly figure to be multiplied with the number of month being seen as the relevant time span. This would avoid negative impacts from one off costs and fluctuations of spending over the year and also eliminate technical accounting influences (e.g. for pension cost which are based on actuarial reports in principle available just once a year). Furthermore this would give more reliability as such figures would be audited prior to usage.

Text 12

- The determination of the number of month for winding down is highly dependent on market conditions at the point in time of winding down and also on the reason which leads to the necessity to wind down. As such factors are unknown, EACH firmly beliefs that an individual calculation is not appropriate. It needs to be taken into account, that in case a winding down is necessary the following components of equity, not used at that point in time to cover positions of Clearing members, are available:
    - (a) the minimum capital of 7.5 million € as required by EMIR article 12 (1),
    - (b) the capital calculated in line with the banking approach (see below),
    - c) the CCPs contribution to the "other financial resources" as required by EMIR Article 41 and
    - (d) the (in principle close to nothing) equity portions as defined in EMIR Article 44 (1a) and excluded from equity for the purpose of EMIR Article 12 (2) and 42 (4) on a going concern basis, which are nevertheless available on a gone concern (i.e. winding done) basis.

On that basis, EACH suggests setting standard winding down periods depending on the complexity of the CCP and the approach applied based on the different models as proposed below.

Q 1

- EACH welcomes that for the "clearing activities" no specific capital requirement is to be added in the proposal on top of the financial resources as requested in EMIR Article 41. EACH agrees that the economic risk of the CCP in the clearing activities is limited to such funds. In that context, EACH wants to point out that the same treatment for these positions should be valid for CCPs operating also with a "banking license" under CRD and that this should be implemented (mirrored) in the banking framework as well.

- As the coverage of x month expenses as a minimum coverage is included in the current CPSS-IOSCO principles draft, we understand, that this component will be one bit of the requirements in any case and we also accept the general approach of having equity in the higher amount of x month operating expenses and the result of a more comprehensive approach (see below). However, in case of full usage of the banking rules and taking into account the minimum equity of 7.5 million €, the usage of x month expense as an additional minimum coverage seems not to be appropriate. The capital coverage for operational risk and the add-on for market risk in that case seem to be sufficient. This might be a topic for alignment also on CPSS-IOSCO level.

- EACH also agrees in principle to the proposal to use the Banking approach for CCPs. But, neither should there be differing (if not clearly derived from EMIR / CRD) and explicitly not more stringent rules nor should the basis of proportionality included in the banking rules be left aside. (see below)

EACH would like to highlight, that the time given was not sufficient to develop an own model. However some EACH members propose the following model to reach proportionality, which is demanded in EMIR. Nevertheless EACH would like to emphasize the existence of other equally valid approaches, which should be chosen flexibly by the various CCPs:

- To include an "operating cost" only model for CCPs that do not take clients' money (i.e. direct participants money) themselves (cash administered by a settlement / collateral agent) <u>and</u> do not operate additional business which (i) requires a license for regulated services or (ii) – according to the competent authority – adds material risk to the CCP. This would follow the logic of article 4 (8) CRR which excludes certain investment firms as defined in MiFID from the application of CRR rules according to their low risk profile. Such CCPs should have 6 month fixed overheads (to be in synch with CRR: one half (6 month) fixed overheads of the CCP for the preceding year [Article 92 (1) CRR]).
- To include a "higher of" model for those CCPs that do not take clients' money themselves (cash administered by a settlement / collateral agent) but operate additional business which (i) requires a license for regulated services or (ii) – according to the competent authority – adds material risk to the CCP. Such regulated service should not be services which require a banking license and hence lead to full

CRR application in it. This would follow the logic of Article 90 – 92 of CRR (i.e.: Such CCPs should follow the rules as laid down in article 92 (1) CRR. CCPs subject to the “operating cost” only model should be allowed to switch to the “higher of” model.

- To use the higher of” model also for large CCPs in case they do not fulfil the above mentioned criteria. “Large” being defined as earning gross revenues (in the sense of the relevant indicator for operational risk in CRR) of 100 mn.
- To include a “CRD” only model to the CCPs those take clients’ money themselves or are subject to CRR due to other activities.

The proposed model is aligned with the proportionality rules of CRD as:

- Small CCPs, that do not take clients’ money do not face substantial credit (and market) risk should not be forced to use the banking approach (even not to calculate it for comparison reason). As the model is less complex, a higher period of cost is to be covered.

- The “higher of” is imposed to those more “risky” CCPs that still do not take clients’ money. This is in line with CRR. Those institutions are obliged to calculate the banking approach. As they do not take clients’ money, the credit and market risk is supposed to be low, but the capital charge for operational risk needs to be covered. As the operational risk for CCPs is supposed to be lower than those of classical banks (due to higher straight through and a limited, but risk focussed business model including the lines of defence for the core activities) it is proposed to follow the 3 month approach of article 92 CRR instead of the 6 month approach for the small CCPs.

- The banking rules only approach is followed as the risks are driven to some extend from credit and market risk (though according to investment guidelines out of EMIR supposed to be limited) and in line with CPSS-IOSCO recommendation 15 – key consideration 3 (“Capital held under international risk based capital standards should be included where relevant and appropriate to avoid double regulation). The avoidance of double regulation is the driving moment and to our understanding both risk adequate as well as in line with EMIR requirements and CPSS-IOSCO principles. We cannot read out of EMIR Article 12 (2) the requirement to determine the tim span for orderly winding-down nor read in CPSS-IOSCO, that the international capital standards cannot replace the minimum period approach. Furthermore, we feel that the proposed approach is proportional to the risks of the CCP as requested by EMIR Article 12 (2).

Q 2

- We have outlined in our answer to question 2 our slightly modified approach. To our understanding this is compliant with EMIR Article 12, CPSS-IOSCO principle 15 and in synch with CRR. It should be noted though, that we strongly recommend to include the additional features (capital deduction for positions out of EMIR Article 44 (1a) and EMIR Article 41 (1) (best done by including as a risk position in CA 2 as proposed in the ITS in CP50)) in the final ITS on COREP under CRR.

2. Operational expenses for winding-down or restructuring

Q 3

- The time span for winding down or restructuring a CCP will differ significantly depending on size, product portfolio, number of trading venues served, organization (especially IT landscape) and the local law (insolvency law). In fact, it can only be determined on the market conditions and cause for winding down at the point in time winding down is necessary. However, we do not see any sense in determining the period as it also is not requested by EMIR (see our proposal above)

Q 4

- EACH believes that there is no uniform approach (one size fits all) in determining the time required for restructuring or winding down.

Q 5

- EACH questions the adequacy of IAS 7 in that context as IAS 7 deals with cash flow.
- As not all CCPs - especially smaller CCPs - prepare accounts according to IFRS, EACH believes it would be an additional burden on those CCPs to prepare a transition calculation from local GAAP to other requirements like IAS 7. In principle the items listed in the Banking Accounting Directive are suitable. As also just a minority of CCPs is subject to this accounting standard, we nevertheless do not suggest imposing this. As far as CCPs annual statements are subject to an audit by an independent auditor the on-going operational expenses (not including extraordinary items) according to local GAAP should be considered adequate for this calculation. We do not see any reason to specify this and refer in this regard to the wording of CRR Article 92.

3. Capital requirements for operational risk

Q 6

- Comments may be given by single CCPs.

Q 7

- EACH believes that the banking framework is an appropriate method for calculating the capital requirement for operational risk. For small and medium size CCPs we however belief, that the minimum equity requirements from EMIR Article 12 (1) and the x month operational cost proposed for winding down time should be sufficient to cover operational losses in a going concern situation. (see our proposal above). This is following the principle of proportionality.

Q 8

- Comments may be given by single CCPs.

Q 9

- EACH believes that the basic indicator approach is appropriate for CCPs, like any other of the approaches allowed under the banking framework.

Q 10

- EACH favours no other indicator. Nevertheless it should be ensured, that the regulation allows flexibility in introducing new alternatives. As the BCBS debate on Basel II has spent years in order to determine an appropriate indicator, we do not feel in a position to repeat these debates with valuable outcome.

Q 11

- EACH believes that there is no need to allocate the CCPs business artificially to a particular business line. In general, the CCP business is not comparable with any real banking activity and from an operational perspective less risky (straight through, highly risk averse and with sophisticated risk management tools).

- The BIA “relevant indicator” seems designed to the banking sector and does not fit CCP activities. But since the rational for operational risk measurement is not sound, it will be difficult to use sound arguments. In the banking industry the indicator is a proxy of a banking product concept. For CCPs some clarification would help.

- EACH questions if CCPs globally hold more or less risk than the banking activity, since banks using BIA are using a 15% rate. The business lines for the Standardised Approach are clearly designed to banking, not to CCPs, so a provisional solution should be set in order to accommodate (new) CCP business within the business lines. CCP activities differ from banking “payment and settlement” activity with an 18% rate.

- A higher weight than 15 % seems therefore not being risk adequate. It is therefore most likely, that the standardised approach is not used by the vast majority of the CCPs. Nevertheless, it should be feasible. (Note, the business lines receiving 12 % only are not relevant for CCPs but the rate of 12 % is closer to the inherent risk of CCPs than the 15 % rate).

Q 12

- Yes, EACH believes, that it should be allowed to calculate the capital requirements for operational risk with an internal model. EACH is in favour to offer full banking rules on capital with all choices given to the banks are also given to the CCPs.

Q 13

- EACH favours no other approach. Nevertheless it should be ensured, that the regulation allows flexibility in introducing new approaches.

4. Capital requirements for credit and market risks stemming from "non-clearing activities"

Q 14

- The Additional Capital is intended to cover on the one hand against market risk, credit risk and counterparty credit risk arising from investment activities and other non-clearing activities; and, on the other hand, to mitigate against operational risk arising from all activities of a CCP (including non-clearing and clearing ones). The term "clearing activity" and "CCP" in EMIR seems to relate to financial instruments/financial markets. We also clear non financial products (physical commodities). We would therefore like to clarify that clearing of non financial markets/instruments is still regarded as clearing (if same organizational measures as for clearing of financial markets/instruments are applied) and therefore can be covered by the financial resources in EMIR articles 39 and following and shall not be covered by Additional Capital.

Q 15

- We refer to our answer given to question 1.

Q 16

- Comments may be given by single CCPs.

Q 17

- EACH believes the standardized approach is adequate. However under Basel III regulation the risk-weight will be increased from 8% to up and around 13%. It needs to be clarified, if the current Basel II or the future Basel III rules should apply. In line with the general approach to follow the banking rules to the extent possible, we would support to follow Basel III, i.e. to have the CRD IV rules in place (for solvency only). However, clear rules need to be in place to monitor future developments and to decide on a case by case basis, which new / revised rules are to be applied in case future changes will happen.

Q 18

- EACH asks for clarification of that question. However EACH would support the approach if the internal models are used by a CCP clearing any products. EACH would not support to limit the approach for derivatives clearing only.

Q 19

- EACH believes that the existing approaches available in the banking framework for market risk are adequate. In total, market risk will be most likely marginal anyway. This is a consequence of the particular risk averse and highly "liquid" business model of a CCP.

Q 20

- EACH favours no other approach. Nevertheless it should be ensured, that the regulation allows flexibility in introducing alternative approaches.

5. Other risks, monitoring and reporting

Text 33

- The existing reporting tools of the relevant authority should be used as far as possible so not to create additional operational cost or disadvantages for CCPs that also hold a banking license. The reporting should be possible by using internet access (i.e. via the existing web reporting tools implemented by the local regulators).

6. Notification threshold

Q 21

- A threshold of 105 % should be implemented in order to be obliged for daily calculation. However, as for the banks this should not lead automatically to reporting obligations. In order to reflect the specific role of CCPs EACH nevertheless considers a reporting obligation being useful, if the breach of the 105 % boundary occurs either several (say 5) days in a row or a dedicated number of days within a given timeframe (e.g. 10 times within 1 month)

Q 22

- EACH believes that restriction measures should be taken if either breaches of the minimum requirement are reported frequently (more than 3 times within 12 month) or a breach persists for more than 15 days in a row.

- Text 33 states that measures should be taken by the competent authority if a CCP does not hold sufficient capital. This is in our view contradictory to Text 35 where the competent authority should take measures already if the information threshold is breached. This is also in contradiction to principle 15 key consideration 5 of the CPSS-IOSCO principles where measures are required if the minimum capital is not achieved. As the measures will depend on the individual circumstances it should be left to the competent authorities discretion to decide measures in case the information threshold is breached or the capital is not sufficient. However the measures taken in case the information threshold is breached should be mainly of informative fashion.

About EACH

European central counterparty clearing houses (henceforth CCPs) formed EACH in 1991. EACH's participants are senior executives specialising in clearing and risk management from European CCPs, both EU and non-EU. Increasingly, clearing activities are not restricted exclusively to exchange-traded business. EACH has an interest in ensuring that the evolving discussions on clearing and settlement in Europe and globally, are fully informed by the expertise and opinions of those responsible for providing central counterparty clearing services.

EACH has 23 members:

CC&G (Cassa di Compensazione e Garanzia S.p.A.)

CCP Austria

CME Clearing Europe Ltd

CSD and CH of Serbia

ECC (European Commodity Clearing AG)

EMCF (European Multilateral Clearing Facility)

Eurex Clearing AG

EuroCCP (European Central Counterparty Ltd)

HELEX AS

ICE Clear Europe

IRGiT S.A. (Warsaw Commodity Clearing House)

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Oslo Clearing ASA

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This document does not bind in any manner either the association or its members.

Responses to this paper should be addressed to:

EACH Chair

Marcus Zickwolff

marcus.zickwolff@eurexchange.com

+49 (69) 2111 5847