

July 31, 2012

RESPONSE TO EBA CONSULTATION PAPER ENTITLED “DRAFT REGULATORY TECHNICAL STANDARDS ON THE CAPITAL REQUIREMENTS FOR CCPs UNDER THE DRAFT REGULATION ON OTC DERIVATIVES, CCPs AND TRADE REPOSITORIES”

EACH, the European Association of Central Counterparty Clearing Houses, welcomes the opportunity to respond to EBA’s Consultation Paper on Draft Regulatory Technical Standards on the capital requirements for CCPs under the draft Regulation on OTC derivatives, CCPs and Trade Repositories (“the Consultation Paper”). EACH has contributed to the development of the associated Level 1 text, “EMIR”, and to EBA’s Discussion Paper, which was submitted on 02nd of April 2012.

EACH 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 welcomes unique capital requirements based on the EMIR rules in articles 16 and 41 – 47. However the current drafts of EBA and ESMA standards taken as a whole are requiring CCPs to hold very significant and potentially excessive amounts of capital. In our view, this overstates the inherent risk of the CCP business model and is therefore disproportionate. Compared to the EBA discussion paper the amount of capital needed by a CCP has already increased by around 150%.

Furthermore, we note that by combining requirements of the banking framework with additional CCPs specific requirements (operational expenses for winding down) the capital requirements imposed on CCPs are going to be more stringent than for banks. Although we recognise the systemic importance of CCPs, we do not believe that the risks taken by CCPs and posed on the financial markets justify such a high level of capital. In our view, the proposed approach does not take into account the fact that CCPs hold initial margins and default funds to cover the potential default of a clearing member, which is arguably the biggest risk faced by CCPs.

The empirically proven risk management capabilities of CCPs is evidenced by the fact that neither the default fund contributions of non-defaulting members or the capital of the CCPs itself has been impacted during the financial crisis to date. The defaults of Lehman and MF Global demonstrated the strength of the CCPs models. Taking the revised future framework under EMIR into account, we feel that CCPs will be further reducing their risk exposure. Because of the existence of adequate initial margins and default funds, CCPs have not had to use the default fund contributions of non-defaulting clearing members or the CCP itself

during the financial crisis. EACH feels that the implementation of the EMIR prudential and organisational standards will further reduce the risks posed by CCPs.

The costs associated with the implementation of the EMIR prudential (capital, default funds) and organisational requirements will significantly increase the cost of central clearing. We are concerned that it could lead to market participants being incentivised to enter into bilateral transactions rather than centrally clear.

Unless consistent capital standards are adopted globally, CCPs outside the EU will benefit from a competitive advantage as their lower capital requirements will allow them to offer lower costs to users. It is the intention of CPSS-IOSCO to set out principles to be adopted by CCPs globally, and EMIR will not assist global consistency of capital requirement standards by going beyond these principles.

EACH would like to highlight seven main concerns. Some EACH members will respond separately in a more detailed manner.

1. Clarification to equally treat spot products and derivatives – Article 1

Under Article 16 (2) of EMIR capital is required to cover market risk and credit risk arising from “non-covered activities” and operational risk arising from all activities of a CCP. Clearing is regulated under EMIR and is a “covered activity” according to the regulation drafts. Where a CCP clears non-financial instruments using equivalent processes and procedures as for financial instruments and in that way ensures that clearing of non-financial instruments is also covered by specific financial resources as referred to in Articles 41 to 44 of EMIR, this should clearly be defined as “covered activity”. Otherwise the CCP would be required to hold capital for these activities although they are covered with specific financial resources as referred to in Articles 41 to 44 of EMIR.

2. The notification threshold should be deleted - Article 4

A notification threshold, as proposed in Article 4 of the Consultation Paper, of 125% is in EACH’s opinion overly conservative as we expect the capital requirements to be relatively stable. Capital requirements for market risk should be close to zero and capital requirements for credit risk should be low as well due to a high degree of either zero weighted positions or sufficient risk reducing impact of financial collateral. Operational expenses for “winding down” and operational risk should also be quite stable.

A high notification threshold will just function as an additional capital rule as CCPs will need to maintain capital over the notification threshold. EACH proposes to lower the notification threshold to the level of 105%-110%, which was already proposed in the Discussion Paper of 6th of March 2012 under section 6 – notification threshold.

3. The contribution to other CCP's default fund should be treated in harmony with the CRR – Article 2

Under the Capital Requirement Regulation (CRR) banks will be required to hold capital against their contributions to the CCP's default fund. The amount of the own fund requirement is the outcome of a complex calculation; nevertheless it will never be 100% of the contribution itself.

According to Article 3.2 (a) of the proposed Standards contributions to the default fund of another CCP shall be deducted from the capital of a CCP. If this means that there is a capital requirement on the CCP equal to the amount of the default fund contribution, this would be an unreasonable burden on CCPs compared to banks. However, we seek clarification that this is not the intention of the EBA and that what is intended is that a CCP's default fund contribution cannot be counted towards the CCP's own capital requirement.

4. The floor for winding-down or restructuring activities should be set at 6 month - Article 6

EACH agrees that it is appropriate that CCPs should hold sufficient financial resources to withstand operational expenses over an appropriate period of time for winding-down or restructuring its activities. Nevertheless EACH disagrees with the time frame of 12 months. In order to be consistent with international standards (CPSS/ISCO Principles for Financial Market Infrastructures) the floor for the winding-down period should be reduced to 6 months.

We propose in general that CCPs should be subject to a 6 month winding down period. In the case the competent authority demonstrates the need of a longer wind down period, the wind down period could be extended to 12 months at most.

5. The amount of capital to be hold should be based on the "higher amount" as contemplated by ESMA in March 2012 and not on "the sum of" – Article 3

It is the spirit of EMIR Art 16(2) to cover both topics - the "winding-down or restructuring of the activities" and "credit, counterparty, market, operational, legal and business risks". However there is no evidence that it was the intention to cover both topics simultaneously. As stated in recital 5 of the CP, it is appropriate that CCPs should hold sufficient financial resources to withstand operational expenses over an appropriate period of time for winding-down or restructuring its activities. This is the current approach taken by the FSA in relation to CCP capital requirements, and for these purposes a 6-month winding down period is used. There is no evident rationale for in addition requiring CCPs to hold capital to cover operational risk. This is duplicative. Such a capital charge, calculated as a proportion of revenues, is inappropriate for CCPs. The fact that such a capital charge is applied to credit institutions and investment firms is not sufficient justification for application to CCPs, and in any case not in addition to the capital charge for winding-down or restructuring its activities.

6. In a wind down scenario, some discretionary expenses would not be incurred and should not be included in the operational expenses computation – Article 6

The consultation paper suggests that a CCP's wind-down expenses are equivalent to its operational expenses for an appropriate time span for winding-down. This is most inappropriate as, in the wind-down state, there are numerous business-as-usual and development activities that a CCP would not be carrying out (for example marketing, strategic systems investment) whilst other material discretionary expenditure, for example bonuses, would be significantly reduced. EACH would suggest that these expenses are not included in the operational expense computation.

7. The Interpretation of resources in accordance with Article 47 (1) - Article 3

Article 3 (2) sub C provides an obligation to deduct from the capital any resources not invested in accordance Article 47 (1) (for which RTS are currently being drafted by ESMA). A strict reading might lead to a situation in which the interpretation of the word "resources" will be decisive for the compliance. If "resources" is to include for example cash held with a collateral agent by a CCP for the provision of collateral under interoperability arrangements or cash held with a settlement agent awaiting deliveries to be paid, this could lead to significant and unwarranted capital deductions, and may lead to capital being highly volatile rather than stable.

The overall requirement has a direct impact on the amount of "dedicated own resources" that a CCP will have to include in its default waterfall.

Furthermore we would like to highlight the linkage between the minimum capital requirement and the amount of 'dedicated own resources' that the CCP will have to include in the default waterfall as proposed in ESMA Level 2 RTS consultation (article 1DW, page 111). This linkage creates de facto an additional capital requirement on activities stemming from clearing activities. This contradicts EMIR level 1 text Articles 39 to 41a, where capital requirements on activities stemming from clearing activities are excluded.

EACH is of the opinion that only a small part of the CCPs capital should be at the first line of risk (skin in the game). In order to avoid systemic risks relating to recapitalization of CCPs and also considering multiple defaults and replenishment of this capital, EACH proposes that the CPP should only have to hold 10% of its capital requirements as 'dedicated own resources'. However we are aware that this issue is subject to the ESMA consultation.

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.)	IRGIT S.A. (Warsaw Commodity Clearing House)
CCP Austria	KDPW_CCP S.A.
CME Clearing Europe Ltd	KELER CCP Ltd
CSD and CH of Serbia	LCH.Clearnet Ltd
ECC (European Commodity Clearing AG)	LCH.Clearnet SA
EMCF (European Multilateral Clearing Facility)	MEFF
Eurex Clearing AG	NASDAQOMX
EuroCCP (European Central Counterparty Ltd)	National Clearing Centre (NCC)
HELEX AS	NOS Clearing ASA
ICE Clear Europe	NYSE Liffe
	OMIClear
	Oslo Clearing ASA
	SIX x-clear AG

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

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