DRAFT REGULATORY TECHNICAL STANDARDS ON

THE CAPITAL REQUIREMENTS FOR CCPs UNDER THE DRAFT REGULATION ON OTC DERIVATIVES, CCPs AND TRADE REPOSITORIES

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An EBA Discussion Paper

A response by the Futures and Options Association

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1.1 This response is submitted on behalf of the Futures and Options Association ("the FOA"), which is the principal European industry association for 160 firms and organisations engaged in the carrying on of business in futures, options and other derivatives. Its international membership includes banks, financial institutions, brokers, commodity trade houses, energy and power market participants, exchanges, clearing houses, IT providers, lawyers, accountants and consultants (see Appendix 1).

1.2 The FOA supports the assurance given by the EBA that its proposal for the capital regulation of CCPs will be grounded on the international standards proposed by CPSS-IOSCO and the related EU Capital Requirements Directives – and that the risk exposures and capital requirements, while likely to be different to banks, will be calculated using approaches set out for banks by the CRD.

1.3 The FOA, in supporting the adoption of the three different approaches for operational risk measurement, namely, the Basic Indicator Approach, the Standardised Approach and the Advanced Measurement Approach, believes that there are a number of significant factors that should be taken into account when determining measurement and design of each approach:

(a) while it is true that CCPs will become increasingly more systemically important to the financial system, the quantum of risk posed to that system will be less than that of banks insofar as the business model is fundamentally different and CCPs are more restricted in terms of investment, collateral, the setting of margins and in the overall business model, i.e. CCPs do not carry on any form of banking business;

(b) full consideration needs to be given to the range and extent of the credit, market and operational risk systems and controls that are designed to substantially reduce the overall risk of CCP default and will bear on overall operational risk (although it is noted that the capital regulation of CCPs will be restricted to non-cleared activities and operational risk).

1.4 The FOA notes that there is a possible conflict in priorities between (a) end-users that wish to hold down the costs of risk management trading in markets as much as possible (which argues for a proportionate approach to margin and a more generous approach to assets deemed eligible for collateral purposes); (b) the clearing members which are anxious to ensure that any risk of a call on a default fund is mitigated as much as possible and that the overarching principle is not "survivors pay" but "defaulter pays" in the event of a default (and that points to higher levels of margin and CCP "skin in the game", before any call is made on a default fund), and (c) the CCPs themselves, which do not want to be confronted with disproportionately high capital requirements (which will also impede the ability of competing CCPs to enter into the market).

1.5 The FOA accepts entirely that, even after taking into account all the factors referred to above, the capital regulation of CCPs does need to be robust. However, it is important also to bear in mind that, while, rightly, CCPs are described as the “Rolls Royce” solution to credit risk mitigation, it is important that they do not become prohibitively expensive as a credit risk mitigant for many end-users(a) particularly those which fall into the category of small or medium-sized enterprises; (b) especially for financial end-users which do not have the benefit of a CCP exemption in the same way as non-financial users, yet which may be trading in the market for exactly the same reasons and purposes.

In this context, the FOA would simply observe that the overall cost of using a CCP is likely to increase significantly for a variety of reasons, namely::

(a) increased clearing fees, in order to pay for the enhanced prudential regulatory and supervision of CCPs;

(b) the collateral and cash flow consequences of higher and more frequently-called margin payments, egfor countercyclical reasons and/or which may include additional “buffers”;

(c) a much more restrictive approach to assets deemed eligible as collateral, which will become increasingly more problematic as demand exceeds supply and which will impact on the costs of collateral transformation;

(d) the “pass on” costs of clearing members; and

(e) the fact that end-users will now be facing margin calls and the obligation to provide collateral for significant numbers of contracts where that obligation did not exist before.

The purpose of these observations is simply to draw to the attention of the EBA the inherent conflict between, on the one hand, incentivising the use of the CCP to address credit risk, particularly in relation to systemically-important contracts which are deemed eligible for CCP clearing and the cumulative impact of the cost of using a CCP which will impact on the economics of using market instruments to manage risk to the point where some end-users may elect to forego their risk management activities for economic reasons and/or price the risk into prices they charge to their customers/clients for their products/services.

For these reasons, the FOA would urge the EBA to look extremely carefully at the potential costs and benefits of its proposed standards for the capital regulation of CCPs.

1.6 The FOAagrees on the approach of the EBA that a CCP should hold capital at least equal to the higher of (i) its operational expenses during an appropriate timespan for winding-down or restructuring its activities; and (ii) the sum of the capital requirements for the overall operational risk and for credit, counterparty and market risks stemming from the “non-clearing” activities it carries out.

1.7 The FOA believes it is critically important that the capital treatment of CCPs and any related disclosure requirements are applied on an even-handed basis to all CCPs to avoid undue competitive advantage, but recognising that different CCPs will have different business models and levels of risk they pose to the system which, in turn, will call for a forensic and proportionate approach to risk calibration.

1.8 The FOA anticipates that not all CCPs will have the systems, controls and models to adopt the Advanced Measurement Approach and that, while it may be policy to incentivise the adoption of that Approach by CCPs, it is important that the alternative Business Indicator Approach and the Standardised Approach are not set at levels that are designed to incentivise CCPs to incur that additional cost.

APPENDIX 1

LIST OF FOA MEMBERS

FINANCIAL INSTITUTIONS
ABN AMRO Clearing Bank N.V.
ADM Investor Services International Ltd
Altura Markets S.A./S.V
AMT Futures Limited
Jefferies Bache Limited
Banco Santander
Bank of America Merrill Lynch
Banca IMI S.p.A.
Barclays Capital
Berkeley Futures Ltd
BGC International
BHF Aktiengesellschaft
BNP Paribas Commodity Futures Limited
BNY Mellon Clearing International Limited
Capital Spreads
Citadel Derivatives Group (Europe) Limited
Citigroup
City Index Limited
CMC Group Plc
Commerzbank AG
CréditAgricole CIB
Credit Suisse Securities (Europe) Limited
Deutsche Bank AG
ETX Capital
FOREX.COM UK Limited
FXCM Securities Limited
GFI Securities Limited
GFT Global Markets UK Ltd
Goldman Sachs International
HSBC Bank Plc
ICAP Securities Limited
IG Group Holdings Plc
International FC Stone Group
JP Morgan Securities Ltd
Liquid Capital Markets Ltd
Macquarie Bank Limited
Mako Global Derivatives Limited
MarexSpectron
Mitsubishi UFJ Securities International Plc
Mizuho Securities USA, Inc London
Monument Securities Limited
Morgan Stanley & Co International Limited
Newedge Group (UK Branch)
Nomura International Plc
Rabobank International
RBC Europe Limited
Saxo Bank A/S
Scotia Bank
S E B Futures
Schneider Trading Associates Limited
S G London
Standard Bank Plc
Standard Chartered Bank (SCB)
Starmark Trading Limited
State Street GMBH London Branch
The Kyte Group Limited
The RBS
UBS Limited
Vantage Capital Markets LLP
Wells Fargo Securities
WorldSpreads Limited

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APX Group
CME Group, Inc.
Dalian Commodity Exchange
European Energy Exchange AG
Global Board of Trade Ltd
ICE Futures Europe
LCH.Clearnet Group
MCX Stock Exchange
MEFF RV
Nasdaq OMX
Nord Pool Spot AS
NYSE Liffe
Powernext SA
RTS Stock Exchange
Shanghai Futures Exchange
Singapore Exchange Limited
Singapore Mercantile Exchange
The London Metal Exchange
The South African Futures Exchange
Turquoise Global Holdings Limited

SPECIALIST COMMODITY HOUSES
Amalgamated Metal Trading Ltd
Cargill Plc
ED & F Man Capital Markets Ltd
Engelhard International Limited
Glencore Commodities Ltd
Koch Metals Trading Ltd
Metdist Trading Limited
Mitsui Bussan Commodities Limited
Natixis Commodity Markets Limited
Noble Clean Fuels Limited
Phibro GMBH
J.P. Morgan Metals Ltd
Sucden Financial Limited
Toyota Tsusho Metals Ltd
Triland Metals Ltd
Vitol SA

ENERGY COMPANIES
BP Oil International Limited
Centrica Energy Limited
ChevronTexaco
ConocoPhillips Limited
E.ON EnergyTrading SE
EDF Energy
EDF Trading Ltd
International Power plc
National Grid Electricity Transmission Plc
RWE Trading GMBH
Scottish Power Energy Trading Ltd
Shell International Trading & Shipping Co Ltd
SmartestEnergy Limited

PROFESSIONAL SERVICE COMPANIES
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BDO Stoy Hayward
Clifford Chance
Clyde & Co
CMS Cameron McKenna
Deloitte
Dewey &LeBoeuf LLP
FfastFill
FidessaPlc
Freshfields Bruckhaus Deringer
Herbert Smith LLP
ION Trading Group
JLT Risk Solutions Ltd
KattenMuchinRosenman LLP
Linklaters LLP
Kinetic Partners LLP
KPMG
Mpac Consultancy LLP
Norton Rose LLP
Options Industry Council
Orrick, Herrington & Sutcliffe (Europe) LLP
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R3D Systems Ltd
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