European Banking Authority (EBA) Consultation Paper of 27 February 2015

Draft Regulatory Technical Standards on prudential requirements for central securities depositories under Regulation (EU) No 909/2014 ('Central Securities Depositories Regulation' – CSD R)

INTRODUCTION

Interbolsa – Sociedade Gestora de Sistemas de Liquidação e de Sistemas Centralizados de Valores Mobiliários, S.A. ("Interbolsa"), the Portuguese CSD, which is part of the EURONEXT Group, welcomes the European Banking Authority's initiative regarding the public consultation launched on 27 February 2015, as regards the draft regulatory technical standards on prudential requirements for central securities depositories under Regulation (EU) no. 909/2014 (the CSD Regulation or CSDR).

As a member of the European Central Securities Depositories Association ("ECSDA"), Interbolsa has participated in the discussion and elaboration of ECSDA's responses to this public consultation and we fully support all the comments included in the paper prepared and submitted by ECSDA.

Nevertheless, Euronext/ Interbolsa considers important to also comment individually the EBA Consultation Paper on CSDR regulatory technical standards, even if we adopt identical terms and positions, or even the same answers as the ones of ECSDA. This paper serves to reinforce the principal aspects of ECSDA comments fully supported by Interbolsa.

Therefore, Euronext/ Interbolsa presents in this document its response to the public consultation concerning the draft technical standards for the regulation on improving securities settlement in the European Union and on central securities depositories (CSD).

This paper constitutes Euronext/ Interbolsa's response to the European Banking Authority (EBA) Consultation Paper (CP) of 27 February 2015 on draft Regulatory Technical Standards under the Regulation (EU) no. 909/2014 of the European Parliament and of the Council of 23 July 2014 (the CSD Regulation or CSDR).

The CSD Regulation introduces a strict distinction between central securities depositories (CSDs) offering banking-type of ancillary services and licensed as a credit institution and those CSDs that are not licensed to offer banking-type of ancillary services but can designate a credit institution to that effect.

Interbolsa is a CSD that does not operate with a banking license, being the banking-type of ancillary services (currently only including debt securities, and corporate actions and settlement of OTC operations) provided by a designated credit institution.

Therefore our response will focus on the draft RTS on capital requirements for non-bank CSDs (article 47 of the CSDR).

We support harmonised and transparent capital requirements for EU CSDs, and it is thus certain that the Regulation Technical Standards (RTS) have the potential to ensure that all EU-authorised CSDs with an identical risk profile are subject to similar capital requirements, based in a risk approach. The level of a CSD capital should be proportional to the risk coming up from de activities of such a CSD, and not a fixed amount of capital.

In general terms, we agree that the capital needs to be sufficient to ensure that the CSD is adequately protected against operational, legal, custody, investment and business risk so that it can continue providing services to the market.

However, we do not agree that operational, legal and investment (credit, market and counterparty credit) risks are addressed in the same way as for CCPs with direct references to the CRR. The risk profile of the CSDs is very low and very different from the risk profile of the CCPs, and it will be difficult to apply the same criteria than the ones applied to CCPs or even to credit institutions, without including some important adaptations. For example, CSDs without banking license do not provide cash credit and are thus not exposed to counterparty credit risk in relation to their participants.

We believe that the regulatory technical standards should be tailored to CSDs' specificities and we fear that they will not be practically implementable unless they include some important adaptations.

Therefore we consider that the framework applied to banks and/or CCPs should be removed from the draft RTS, because it is inappropriate in a CSD context.

INTERBOLSA's responses to the EBA Public Consultation on CSD prudential requirements

Q1. What are the practical impediments of calculating capital requirements for custody risk as set out in Article 5?

Custody risk is not addressed in a separate article in the CSDR Level 1 text because it was considered to assess both types of risks (custody and investment risk) in relation to the CSD's own assets.
This custody risk should be assessed as a risk faced by the CSD itself, and not the custody risks faced by the CSD participants (holding securities directly in a CSD's own books or via CSD links), which we consider that is already covered under operational and legal risks faced by the CSD.

Considering the above said, we believe that there is nothing in Level 1 CSDR which requires (or even suggests) that custody risks faced by CSD participants, including via CSD links, should be considered for the purpose of CSD capital requirements. Therefore it should be avoided, in our point of view, unnecessary duplication of requirements and inconsistencies with Level 1 text, and therefore, Interbolsa suggests deleting article 5 of the draft RTS and consider the reference to custody risks only in article 4 of the draft RTS (in line and consistently with the Level 1 text).

We reiterate the idea that CSDs are, in this context, different from banks and CCPs, namely because they are primarily exposed to operational risk, with investment and custody risks being very marginal.

Without prejudice in what concerns the above said, we want to highlight the following aspects:

(i) CSD links as a criterion to the assessment of custody risks

We consider that the amount of CSD capital reserved for covering legal and operational risks already covers scenarios related to the loss or damage of client securities, namely via a CSD link.
On the other hand the rational to require CSDs to hold more capital for each CSD link they maintain does not seem very clear. In fact, we consider that this could have counterproductive effects and is not aligned with the objectives of integration and settlement efficiency, namely in a T2S context and regarding T2S and CSDR objectives.

(ii) The method for calculating custody risks

The reference to the Capital Requirements Regulation (CRR) Standardised Approach for operational risk does not seem adequate and even difficult to be applied to the CSDs activities. Actually, and considering the list of business lines identified (see article 317 of the CRR) we cannot include the activities of Interbolsa in several of the activities (*business lines*) described. In the exercise that we have performed related to the impact of EBA's proposal in Interbolsa's capital we only have elements to fill in two business lines [6) Payment and settlement; and 7) Agency services ([1]) (safekeeping and administration of financial instruments, including custodianship and related services such as cash/collateral management)].

Once again we reiterate that the difficulty to fulfil the criteria relates to the different risk profiles of the CSDs and of the banks and CCPs.

Q2. Is the level of capital requirements as proposed in these draft RTS (Articles 1-8) adequate to capture all the risks arising from the activities of a CSD? Are they proportionate for all the CSDs' business models? Please justify your answer.

In general terms, and as referred above in the introduction we support harmonised and transparent capital requirements for EU CSDs, and we believe that the draft RTS on capital requirements have the potential to ensure that all EU-authorised CSDs with an identical risk profile are subject to similar capital requirements (based in a clear differentiation among CSDs based in their risk profile). The level of a CSD capital should be proportional to the risk coming up from de activities of such CSD, and as such tailored to the risk profile of the CSD.

The reference to the CRR, designed for banks, does not seem, as proposed by EBA, the best, feasible and easy approach (namely to the competent authorities) to assess the appropriate capital level of the CSD. Actually, and as said before CSDs, like Interbolsa that does not perform banking-type ancillary services, are not exposed to credit and liquidity risk in relation to their core activities.

We consider that a consistent approach should be the assessment of operational risk which is the main risk faced by CSDs and not put the focus on risks which are marginal for CSDs (such as investment, credit and liquidity risks).

Currently, the minimum capital requested for market infrastructures is a fixed amount. Considering the minimum capital requested by the Portuguese law ([2]) for entities managing centralized securities

([1]) Nevertheless, we have serious doubts regarding the "agency services", because the definition included in the CRR is different from the central maintenance service as established in the CSDR.
([2]) The Ministerial Order no. 1619/2007, of 26 December establishes the capital of the market infrastructures, and Decree-law n0 357-C/2007, of 31 October and CMVM Regulation no. 4/2007, establish some prudential rules to be applied to Interbolsa.

systems and securities settlement systems ([3]), the impact regarding the implementation of the EBA's proposal RTS in what concerns capital requirements will be considerable (almost the double).

In what concerns, the specific proposals established in articles 1-8 of EBA draft RTS proposal, we highlight the following aspects:

Article 1: Overview of requirements regarding the capital of a CSD
We agree with the drafting of article1 of the draft RTS.

Article 2: Definition of capital of a CSD
We agree with the proposed definition of capital under article2 of the draft RTS**.**

Article 3: Level of capital requirements for a CSD
In what concerns article 3(b) – CSD's capital requirements for custody risks - we should refer to what was said above regarding the CSD's capital requirement for custody risks calculated in accordance with article 5 of the draft RTS.
The capital of a CSD must be sufficient to cover the risks described under articles 43 (legal), 44 (business risk), 45 (operational) and 46 (investment and custody risk). It does not aim to include custody risks faced by CSD participants is not included , and, as such, paragraph 1 (b) of article 3 of the draft RTS should be deleted, since custody risks are already considered under art.3(1)(a).

Article 4: Level of capital requirements for operational, legal and custody risks
This article needs some adjustments in order to allow for a proper evidence of the CSD' risk profile in its capital requirements, namely for assessing operational and legal risks, we suggest a ratio of 10 % instead of the referred 15%, to reflect CSDs' lower risk profile, also considering the specific insurance arrangements covering operational and legal risk.
Interbolsa has never suffered any operational losses.

Article 5: Level of capital requirements for custody risks
We should refer to what was said above regarding the CSD's capital requirement for custody risks calculated in accordance with article 5 of the draft RTS.

([3]) According to the Portuguese law, Interbolsa is subject to a minimum share capital requirement of €2.75 million and to a minimum equity requirement of € 5.5 million.

Article 6: Level of capital requirements for investment risk

Client fees are the primary source of income of Interbolsa. Investment and custody risks are thus very marginal compared to operational risk. Besides, given that Interbolsa always complied with a restrictive investment policy (identical to the one established now in CSDR) investing its assets in highly liquid instruments, investment risk is extremely low for Interbolsa.

We also consider that some aspects of the proposed method for calculating capital requirements in relation to investment risk will not apply in the case of non-bank CSDs (e.g. entering into derivatives transactions).

Article 7: Capital requirements for business risk and Annex II on business risk scenarios

For assessing business risk, we suggest a ratio of 10% instead of the referred 25%, considering the CSDs low risk activities.

On the other hand, CSDs should be allowed to use current year's income to cover business risks, and not only capital.

As regards Annex II, on business risk scenarios, we believe that predefined business risk scenarios are not the most appropriate means to calculate capital requirements for business risk. To achieve efficiency and proportionality, we support a more flexible approach, similar to that in EMIR (for example use reasonable and foreseeable adverse scenarios relevant to the CSD's business model, as approved by the competent authority).

Article 8: Capital requirements for winding-down or restructuring and Annex I on winding-down or restructuring scenarios

CSDs should only have to set aside capital for winding-down or restructuring their activities to the extent that this does not overlap with capital requirements for business risks.

Finally, CSDs should have the possibility to remove certain expenses from gross expenses, in particular:

- when these are not relevant in a winding-down situation, e.g. because they can be cancelled immediately from the moment the CSD enters into a restructuring (e.g. bonuses, staff and commercial events, large projects);
- when these do not involve a cash outflow, such as depreciation and amortization expenses from the wind-down charge.

Q3. What are the operational or practical impediments to the implementation of the proposed methodology for the calculation of the capital surcharge (Article 9)? Do you envisage any amendment to the proposed methodology that might lead to a better measurement and management of those risks?

We agree with the points raised by ECSDA regarding the methodology for the calculation of the capital surcharge. This methodology is based on theoretical and extreme scenarios that are not always realistic. In particular, the assumed 10% drop in market value of all collateral, in addition to already very conservative haircuts applied, does not seem to be an appropriate scenario and should be revised.

Moreover, the calculation of the capital surcharge which reflects intraday credit exposures duplicates to a certain degree existing capital requirements for end of day exposures which are already taken into account under the CRR. The latter should therefore be subtracted from the calculation of the capital surcharge under article 9.

We assume that the draft RTS should not apply to the CSD-Banking service provider (the credit institution designated by the CSD to provide those services) that benefits from the exemption established in article 54, paragraph 5 of the CSDR (paragraph 5 refers expressly that paragraph 4 does not apply to the credit institutions that comply with the terms and threshold referred in paragraph 5).

Q4. To what extent do CSD-banking service providers have the capability to have a real-time view on their positions with their cash correspondents, based on compulsory information provided by those cash correspondents (Article 14)?

The proposed requirements are mainly introduced to monitor the liquidity risks of correspondent banks, and, as such, they should be governed by bank regulation rather than by the CSD regulation. The inclusion of those requirements in CSD Regulation will imply that they would only be applicable to CSDs.

As a final point, we would like to point out that the recordkeeping requirements for intraday and overnight risks included in article 14 are impossible for CSDs to implement and not in line with article 29 of CSDR on record-keeping.

Q5. What might be the practical, legal or operational impediments to the methodology set out in Sub-section on Collateral and other equivalent financial resources (Article 18)?

No comments. Interbolsa is not a bank-CSD.

Q6: What are the practical impediments of the implementation of Article 24?

No comments. Interbolsa is not a bank-CSD.

Q7. To what extent do CSD-banking service providers hold their intraday liquidity risk buffers independently to other liquidity risk buffers, such as the Liquidity Coverage Ratio (LCR)? If this is not currently done, are there any obstacles to ensuring this? Can CSD-banking service providers estimate the intraday buffer assets required to meet Article 35 compared to the assets that they currently hold that would qualify as eligible liquid assets under this Regulation beyond the minimum LCR standard?

No comments. Interbolsa is not a bank-CSD.