



**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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## **DRAFT REGULATORY TECHNICAL STANDARDS ON THE CAPITAL REQUIREMENTS FOR CCPs UNDER THE DRAFT REGULATION ON OTC DERIVATIVES, CCPs AND TRADE REPOSITORIES**

- 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 the 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; and (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, e.g. for 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 FOA agrees 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.

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