



Via E-Mail

November 16, 2016

Olivier Guersent
Director General, DG Financial Stability, Financial Services and Capital Markets Union
European Commission
1049 Brussels
Belgium

RE: Extension of the Transitional Periods Related to Own Funds Requirements for Exposures to Central Counterparties

Dear Mr. Guersent:

The Options Clearing Corporation (“OCC”) appreciates the opportunity to submit comments to the European Commission (“EC”) on the draft implementing regulation (“Draft Regulation”) that would extend the transitional periods related to own funds requirements for exposures to central counterparties (“CCPs”) set out in Regulations (EU) No 575/2013 and (EU) No 648/2012 of the European Parliament and of the Council.¹ The current transitional periods would expire on December 15, 2016, and the Draft Regulation would extend those periods to June 15, 2017. As described below, OCC is directly impacted by the Draft Regulation as a U.S.-based CCP that applied for recognition status (“Recognition”) under Article 25 of the European Market Infrastructure Regulation (“EMIR”) with the European Securities and Markets Authority (“ESMA”). OCC completely agrees with the concerns expressed in the Draft Regulation that European institutions could be harmed and markets could be disrupted if the transitional periods are not extended. Accordingly, OCC is strongly in favor of the EC adopting the Draft Regulation, and also strongly encourages the EC to further extend the transitional periods beyond June 15, 2017 as necessary. OCC also applauds the EC for soliciting public comment on the Draft Regulation to provide market participants with earlier notice of contemplated actions by the EC, which helps promote market certainty.

About OCC

OCC, founded in 1973, is the world’s largest equity derivatives clearing organization. Although OCC began as a clearinghouse for exchange-listed equity options, it has significantly

¹ See (https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2016-6011862_en). This letter supplements the electronic comments OCC submitted on November 16, 2016 (https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2016-6011862/feedback_en). Regulation (EU) No 575/2013 forms part of the “CRD IV” package of legislation implementing Basel III capital requirements for European Union “EU” banks and their affiliates, as well as certain investment firms. Regulation (EU) No 648/2012 adopted the European Market Infrastructure Regulation (“EMIR”).

expanded the scope of the products it clears since its founding. OCC operates under the jurisdiction of both the Securities and Exchange Commission (“SEC”) and the Commodity Futures Trading Commission (“CFTC”). As a registered clearing agency under SEC jurisdiction, OCC clears transactions in exchange-listed options, security futures and OTC options. As a registered derivatives clearing organization under CFTC jurisdiction, OCC clears transactions in futures and options on futures. OCC also provides central counterparty clearing and settlement services for securities lending transactions. In addition, OCC has been designated by the Financial Stability Oversight Council as a Systemically Important Financial Market Utility (“SIFMU”) under Title VIII of the Dodd-Frank Act. As a SIFMU, OCC is also subject to oversight by the Board of Governors of the Federal Reserve System.

As the sole clearinghouse for the U.S. listed options market, OCC’s clearing members include some of the largest banks in the world by asset size, including 18 members affiliated with European banks or other European financial institutions (“European Members”). In 2015, over 21% of our average daily open interest and over 17% of our volume was cleared by our European Members. Our European Members also significantly contribute to OCC’s financial risk management framework, contributing over \$3 billion to our clearing fund and over \$9.5 billion in initial margin posted with OCC, approximately 25% and 23% of all contributions, respectively.²

OCC Comments

As you are aware, EMIR came into force in the EU in 2012 as part of EU efforts to implement G20 mandates regarding OTC derivatives regulatory reform following the 2008 financial crisis. Under EMIR, third country CCPs such as OCC must receive Recognition from ESMA in order to, among other things, be deemed a Qualifying Central Counterparty (“QCCP”)³ under the EU Capital Requirements Regulation (the “CRR”).⁴

The consequences for OCC not receiving Recognition are severe, and would include the following:

1. OCC members that are part of a wider consolidated group that includes an EU entity subject to the CRR would need to apply a 1250% risk weighting to their clearing fund contributions, resulting in a substantially higher capital requirement than would otherwise apply.⁵ As of December 31, 2015, OCC estimates that this would translate into an increase in risk weighted assets (“RWA”) for our European Members for their collective exposures to OCC from approximately \$924 million to over \$75 billion, which in turn translates to an increase in capital requirements of over \$5.25 billion (rising from approximately \$74 million to over \$6 billion). The RWA and correlating capital

² These contributions reflect data as of December 31, 2015.

³ A CCP which has been authorised or recognised under EMIR.

⁴ *See supra* note 1.

⁵ *See* Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms and Amending Regulation (EU) No 648/2012, Articles 306-309. The timing of implementation of the risk weighting charge is currently December 15, 2016.

requirements, however, fluctuate depending on the size of OCC's guaranty fund at any given time.⁶

2. Transactions cleared through our European Members or by any of our clearing members on behalf of end customers that are themselves subject to regulation under the CRD capital requirements regime would separately attract substantially higher capital requirements. OCC does not have data that would allow us to determine the potential impact if this were to occur, though we would expect there to be a meaningful increase in capital requirements here as well. These increased capital charges, which apply to trade exposures, would not only affect OCC clearing members, but would also affect those of their clients that are CRR-regulated, thus creating a ripple effect that is difficult to quantify.
3. The obligation for EU entities to clear certain classes of OTC derivatives declared subject to mandatory clearing by EMIR through QCCPs could not be satisfied by clearing through OCC.
4. OCC would be unable to directly provide clearing services to EU trading venues or to admit an entity established in the EU as an OCC member.

Given these severe consequences, as well as the significant role that our European Members and European market participants play in the derivatives markets for which we clear, OCC applied for Recognition with ESMA in September 2013. OCC's application for Recognition was deemed complete by ESMA in November 2014. The next step in the Recognition process is for the EC to make a determination that the regulatory regime in OCC's home country imposes requirements equivalent to those required by EMIR ("Equivalency Determination"). Although OCC is regulated as a CCP in the U.S. by both the CFTC and SEC, the SEC is OCC's primary regulator. For CCPs like OCC that are primarily regulated by the SEC, we understand that such a determination would need to be made with regard to the SEC's CCP regulatory regime.⁷ The EC made such a determination for the CFTC's CCP regulatory regime in February of this year, but it has not done so yet for the SEC's CCP regulatory regime.⁸ We understand that discussions between EC and SEC staff regarding an Equivalency Determination for the SEC's CCP regulatory regime are currently ongoing. Once such a determination is made, ESMA will be able to move forward with OCC's application for Recognition.

⁶ For example, in July 2015 the RWA would have increased from just over \$1.6 to over \$30.4 billion, resulting in a capital requirement increase of approximately \$2.4 billion (rising from approximately \$129 million to over \$2.4 billion).

⁷ We understand that OCC is in a unique position among U.S. CCPs that have applied for recognition, given that its primary regulator is the SEC, and also that it operates a combined clearing fund for both CFTC and SEC regulated products.

⁸ The Draft Regulation notes that three CCPs from the U.S. have been recognized after the adoption of Implementing Regulation (EU) 2016/892, under which the EC extended the transitional periods to December 15, 2016.

To give this SEC equivalence process sufficient time, it is critical for the EC to extend the date by which the CRR capital requirements noted above become effective by adopting the Draft Regulation. Without such an extension, exposures to OCC will become subject to significantly increased capital charges. OCC is very concerned that such increases in capital charges may force our European Members and impacted market participants to exit the U.S. listed options market, and for some market participants, to exit the underlying U.S. equities markets as well. This could needlessly divert capital to other types of investment products, including uncleared equity options products, which clearly runs contrary to the G20 mandate to promote central clearing. Moreover, U.S. equities options exchanges may experience decreased liquidity and wider bid-ask spreads once these increased capital charges take effect, in part, because of the significant volume of U.S. listed options cleared by our European Members, and the U.S. stock markets may experience a decrease in liquidity as well.

The Draft Regulation cites these very concerns as a basis for extending the transitional periods, noting that if the transitional periods are not extended, “institutions established in the Union (or their subsidiaries established outside the Union) having exposures to the remaining [un-Recognized] third-country CCPs would be required to increase significantly their own funds for those exposures,” and that “[e]ven if such increases may only be temporary, they could potentially lead to the withdrawal of those institutions as direct participants in those CCPs or, at least temporary, to the cessation of the provision of clearing services to those institutions' clients and thus cause severe disruption in the markets in which those CCPs operate.” As discussed above, OCC strongly shares these concerns, and therefore requests that the EC adopt the Draft Regulation to avoid them. Moreover, to the extent that it becomes apparent next year that additional time is needed after the current extension to June 15, 2017 to make additional Equivalency Determinations (including the SEC Equivalency Determination) or for ESMA to process outstanding CCP applications for Recognition, OCC urges the EC to grant such extensions as necessary to avoid the severe damage to the markets that would occur without them.

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We appreciate the opportunity to submit these comments, and are more than happy to discuss them further with staff at the EC and ESMA as they work through the Recognition process.

Respectfully submitted,



Craig S. Donohue
Executive Chairman & CEO
The Options Clearing Corporation