clear to trade

Eurex Clearing
Comments
to the

CPSS-IOSCO Consultative Reports

"Assessment methodology for the principles for FMIs and the responsibilities of authorities"

and

"Disclosure framework for financial market infrastructures"

June 2012

A. Introduction

Eurex Clearing is a globally leading central counterparty clearinghouse (CCP) and the largest clearinghouse in Europe. Eurex Clearing is a subsidiary of Deutsche Börse Group providing central clearing services for cash and derivatives markets both for listed as well as certain over-the-counter (OTC) financial instruments. Eurex Clearing actively contributes to market safety and integrity with state-of-the-art market infrastructure both in trading and clearing services as well as with industry leading risk management services for the derivatives industry. Customers benefit from a high-quality, cost-efficient and comprehensive trading and clearing value chain.

Eurex Clearing AG is a company incorporated in Germany and licensed as a credit institution under supervision of the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) pursuant to the Banking Act (Gesetz für das Kreditwesen). The Financial Services Authority (FSA) has granted Eurex Clearing status as a Recognised Overseas Clearing House (ROCH) in the United Kingdom.

Eurex Clearing welcomes the opportunity to comment on the consultative reports on "Assessment methodology (AM) for the principles for FMIs and the responsibilities of authorities" and "Disclosure framework (DF) for financial market infrastructures" related to the final Principles for Financial Market Infrastructures" published by the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO) in April 2012.

This comment paper combines the answers to both consultations and is arranged as follows. The first section contains a summary of our general observations on the CPSS-IOSCO consultation papers. The second section provides detailed comments for both consultation reports on each principle.

B. Comments

B 1: Summary of general observations

We acknowledge the efforts by the Committees of CPSS and IOSCO to provide a single set of standards aiming at consistency in the oversight and regulation of FMIs worldwide.

We understand that the assessment methodology (AM) is targeted to support external auditors whereas the disclosure framework (DF) aims at giving guidance to the FMI on the disclosure requirements to comply with the new principles. Both documents are closely linked, however a clear indication is missing with respect to the exact interdependencies of the information required.

- The AM outlines the key considerations, the key elements and poses open questions with respect to the key elements.
- The DF lists the key considerations and the key elements without questions to the key elements.

Given this close link between the two documents it should be stated in the final reports that the results of the AM can be used as a basis for the DF. For the latter confidential information should be excluded.

A duplication of work to answer both reports independently and potentially in two different formats would place tremendous administrative burden on the FMIs and should be avoided.

For most of the general description of the FMI the disclosure framework provides only very general guidance. Since the required level of detail is left open it should be made clear that the required disclosure should give an overview of the FMIs organization, market(s) served and key metrics only and is not required to depict all details of all areas.

It should also be possible to combine narratives in the AM as well as in the DF for different key considerations and key elements as there is substantial overlap in some cases (e.g. between key considerations in principle 1 or in principle 7).

In addition, it has to be ensured that the responses to the disclosure framework will be made publicly available only for those parts that do not contain confidential information.

B 2: Detailed comments

Principle 1: Legal Basis

Key considerations 1 - 4 define in the key elements criteria such as "legal certainty", "consistency with relevant laws and regulations", "enforceability" and "degree of certainty that actions will not be voided, reversed, or subjected to stays"

Comment Eurex Clearing does not have any comments on this principle.

Principle 2: Governance

Key consideration 1 of this principle states that "An *FMI should have objectives that place a high priority on the safety and efficiency of the FMI and explicitly support financial stability and other relevant public interest considerations*

Comment: It remains unclear what "other relevant public interest considerations" should be. More definition would be needed to allow that disclosure frameworks of FMIs are also comparable across market infrastructures/ CCPs.

For key element 1 of the AM *"Identification of the FMI's objectives"* question Q.2.1.2 asks: "*How is the FMI's performance in meeting its objectives assessed"?*

Comment: High level objectives (e.g. integrity, safety as well as financial stability) are hard to measure. More detailed objectives are not comparable across CCPs. Maybe this should read "How does the FMI assess its performance in meeting its objectives?"

Key consideration 4 of this principle states, that *"The board should contain suitable members with the appropriate skills and incentives to fulfil its multiple roles. This typically requires the inclusion of non-executive board member(s)".*

Comment:
To achieve comparability across the industry, it would be helpful if there are minimum definitions of what "appropriate skills" should mean. Every FMI would otherwise interpret appropriate differently and narrow it down to its own business but not to the functioning of a FMI in general.

Key consideration 5 of this principle states, that *"The roles and responsibilities of management should be clearly specified. An FMI's management should have the appropriate experience, a mix of skills, and the integrity necessary to discharge their responsibilities for the operation and risk management of the FMI"*.

Comment:
A definition of "appropriate experience" would be helpful to achieve common standards across FMIs.

Key consideration 7 of this principle states, that "The board should ensure that the FMI's design, rules, overall strategy, and major decisions reflect appropriately the legitimate interests of its direct and indirect participants and other relevant stakeholders. Major decisions should be clearly disclosed to relevant stakeholders and, where there is a broad market impact, the public".

Comment:
There is much room for interpretation of what "legitimate interests" shall mean and what "appropriately reflected" shall mean. This may result in some FMIs being much more responsive to the direct or indirect participants, whereas others simply define the member requests as not-legitimate?

Principle 3: Framework for the comprehensive management of risks

Comment
Eurex Clearing does not have any comments on this principle.

Principle 4: Credit risk

Key consideration 5 states that *"A CCP should determine the amount and regularly test the sufficiency of its total financial resources available in the event of a default or multiple defaults in extreme but plausible market conditions through rigorous stress testing. A CCP should have clear procedures to report the results of its stress tests to appropriate decision makers at the CCP and to use these results to evaluate the adequacy of and adjust its total financial resources. Stress tests should be performed daily using standard and predetermined parameters and assumptions. On at least a monthly basis, a CCP should perform a comprehensive and thorough analysis of stress testing scenarios, models, and underlying parameters and assumptions used to ensure they are appropriate for determining the CCP's required level of default protection in light of current and evolving market conditions. A CCP should perform this analysis of stress testing more frequently when the products cleared or markets served display high volatility, become less liquid, or when the size or concentration of positions held by*

a CCP's participants increases significantly. A full validation of a CCP's risk-management model should be performed at least annually".

Comment: A CCP should disclose details related to its stress testing program while being allowed to keep confidential the stress testing results. Disclosing such result could potentially destabilize the market, particularly when products cleared or markets served display high volatility or positions are large. As a result, the ability of the CCP to effectively measure, monitor and manage its credit exposure to participants as part of a robust risk framework would be undermined.

Principle 5: Collateral

Key consideration 2 of this principle states, that *"An FMI should establish prudent valuation practices and develop haircuts that are regularly tested and take into account stressed market conditions"*.

Comment: Description of collateral valuation policies and haircut methodology should be made available to clearing members and the general public. However, this should be done on a high-level basis only. CCPs should not be forced to publish their valuation algorithms.

Principle 6: Margin

Key consideration 2 outlines that "*A CCP should have a reliable source of timely price data for its margin system. A CCP should also have procedures and sound valuation models for addressing circumstances in which pricing data are not readily available or reliable".* The key element "Identification of valuation models for calculating margin requirements when market prices are not readily available or reliable" is assigned to this key consideration.

Comment The key element should be extended from pure identification of the respective valuation models into the direction of availability of the model. The implication of "unreliable prices" for the risk measurement, e.g. by naming "materiality" based on open interest or "adjustments for illiquidity" if data is flawed should be considered.

For key consideration 3, key element 2 *"Close out and sample periods for margin model*" the following question is posed in the AM consultation paper *"Q.6.3.6: How does the CCP consider the trade- off between prompt liquidation and adverse price effects?*"

Comment The question should rather ask how the margin methodology considers the adverse price effect resulting from a prompt liquidation, e.g. by the liquidity add-on. It cannot be considered as an option to defer the liquidation hoping for better market conditions.

Principle 7: Liquidity Risk

Comment Eurex Clearing does not have any comments on this principle.

Principle 8: Settlement finality

Comment Eurex Clearing does not have any comments on this principle.

Principle 9: Money Settlements

Key consideration 3 of this principle states, that "*If an FMI settles in commercial bank money, it should monitor, manage, and limit its credit and liquidity risks arising from the commercial settlement banks. In particular, an FMI should establish and monitor adherence to strict criteria for its settlement banks that take account of, among other things, their regulation and supervision, creditworthiness, capitalisation, access to liquidity, and operational reliability. An FMI should also monitor and manage the concentration of credit and liquidity exposures to its commercial settlement banks*".

Comment Please clarify in the final report that only the key aspects of the due diligence methodology must be disclosed and not the specific results of the due diligence itself.

Principle 10: Physical delivery

Comment Eurex Clearing does not have any comments on this principle.

Principle 11: Central securities depositories

Comment Eurex Clearing does not have any comments on this principle.

Principle 12: Exchange-of-value settlement systems

Comment Eurex Clearing does not have any comments on this principle.

Principle 13: Participant-default rules and procedures

Key consideration 4 of this principle states, that "*An FMI should involve its participants and other stakeholders in the testing and review of the FMI's default procedures, including any close-out procedures. Such testing and review should be conducted at least annually or following material changes to the rules and procedures to ensure that*

they are practical and effective." The DF report lists the following associated key element: "Testing and review of the default procedures with participants and other stakeholders."

Comment The key element should clearly define what information is required regarding "testing and review", e.g. a test schedule, broad scope of the tests, no test cases as well as responsibilities of the involved members. Also the resolution regime of a CCP should be disclosed and therefore added to the minimum disclosure requirements.

Principle 14: Segregation and portability

Key consideration 2, key element 2 *"Ability of the CCP to readily identify positions of its participants' customers and to segregate related collateral."* the following question is posed in the AM consultative paper: *"Q.14.2.3: Does the CCP rely on the participant's records containing the sub-accounting for individual customers to ascertain each customer's interest? If so, describe how the CCP ensures its access to this information. Is customer margin obtained by the CCP from its participants collected on a gross or net basis? Is a customer's collateral exposed to "fellow-customer risk"?"*

Comment When a CCP relies on the participants records and has access to the records, how shall the CCP ensures that the received records are correct? In addition, please specify what is meant with "fellow-customer risk" in that respect.

Principle 15: General business risk

Key consideration 3 of this principle states, that *"An FMI should maintain a viable recovery or orderly wind-down plan and should hold sufficient liquid net assets funded by equity to implement this plan. At a minimum, an FMI should hold liquid net assets funded by equity equal to at least six months of current operating expenses. These assets are in addition to resources held to cover participant defaults or other risks covered under the financial resources principles. However, equity held under international risk-based capital standards can be included where relevant and appropriate to avoid duplicate capital requirements".*

Key consideration 5 of this principle states, that *"An FMI should maintain a viable plan for raising additional equity should its equity fall close to or below the amount needed. This plan should be approved by the board of directors and updated regularly".*

Comment The disclosure of the detailed plan for orderly wind-down or raising additional capital should not be mandatory.

Principle 16: Custody and investment risk

Key consideration 1 of this principle states, that *"An FMI should hold its own and its participants' assets at supervised and regulated entities that have robust accounting practices, safekeeping procedures, and internal controls that fully protect these assets".* The key elements to this key consideration require disclosure of the

- Characteristics of the entities at which the FMI holds it assets
- Ability of the entities to protect the FMI's and its participants' assets.

Comment
Custody policy should be described on a high-level only. The criteria for the selection and monitoring of payment banks (non-central banks) could also be made public. It should be clarified, if CCPs should be required to list these entities by name. Furthermore, segregation procedures should be described and made public.

Key consideration 3 of this principle states, that *"An FMI should evaluate and understand its exposures to its custodian banks, taking into account the full scope of its relationships with each".*

Comment
Information as required by key consideration 3 can be published on an aggregate level, however details, e.g.: exact names and numbers should not be required to be disclosed.

Key consideration 4 of this principle states, that *"An FMI's investment strategy should be consistent with its overall risk- management strategy and fully disclosed to its participants, and investments should be secured by, or be claims on, high-quality obligors. These investments should allow for quick liquidation with little, if any, adverse price effect".*

Comment
The disclosure of the investment strategy including tenor rules should be required only without naming amounts invested. However, the types of investments allowed and their tenors could be disclosed but without mentioning the specific investments. Also, general criteria for choosing investment partners may also be disclosed.

Principle 17: Operational risk

Key consideration 5 of this principle states, that *"An FMI should have comprehensive physical and information security policies that address all potential vulnerabilities and threats".*

Key consideration 6 of this principle states, that "*An FMI should have a business continuity plan that addresses events posing a significant risk of disrupting operations, including events that could cause a wide-scale or major disruption. The plan should incorporate the use of a secondary site and should be designed to ensure that critical information technology (IT) systems can resume operations within two hours following disruptive events. The plan should be designed to enable the FMI to complete*

settlement by the end of the day of the disruption, even in case of extreme circumstances. The FMI should regularly test these arrangements".

Comment
A CCP should not be required to disclose details of its business continuity plan (eg. location of secondary site) as well as the crisis management and communication.

Principle 18: Access and participation requirements

Comment
Eurex Clearing does not have any comments on this principle.

Principle 19: Tiered participation arrangements

Key Consideration 2 of this Principle states, that "An FMI should identify material dependencies between direct and indirect participants that might affect the FMI".

Furthermore Key Consideration 3 of this Principle states, that "An FMI should identify indirect participants responsible for a significant proportion of transactions processed by the FMI and indirect participants whose transaction volumes or values are large relative to the capacity of the direct participants through which they access the FMI in order to manage the risks arising from these transactions".

Comment
It should under no circumstance be required to disclose the identity of clearing member's clients and the dependencies between members and clients to the public. These relationships are of confidential nature.

Principle 20: FMI Links

Comment
Eurex Clearing does not have any comments on this principle.

Principle 21: Efficiency and effectiveness

Comment
Eurex Clearing does not have any comments on this principle.

Principle 22: Communications procedures and standards

Comment
Eurex Clearing does not have any comments on this principle.

Principle 23: Disclosure of rules and key procedures

Key consideration 1 of this principle states, that *"An FMI should adopt clear and comprehensive rules and procedures that are fully disclosed to participants. Relevant rules and key procedures should also be publicly disclosed".*

Comment Please clarify the definition of "relevant" rules and "key" procedures. Without the definition the point leaves room for interpretation, thus a homogeneous result across the industry is endangered.

Key consideration 5 of this principle states, that *"An FMI should complete regularly and disclose publicly responses to the CPSS-IOSCO Disclosure framework for financial market infrastructures. An FMI also should, at a minimum, disclose basic data on transaction volumes and values".*

Comment Please clarify the definition of "basic data". To allow a comparison through the FMIs it has to be clear what kind of data needs to be disclosed.

Principle 24: Disclosure of market data

Comment Eurex Clearing does not have any comments on this principle.

Annex 2: Key metrics for CCPs

The following should be excluded as it contains either confidential information or is no information that is useful to describe the risk of a CCP:

- Value of routine margin collection vs. non routine margin calls
- Initial Margin requirement of sample portfolios (if regulators want to compare the results than an ad hoc request is more adequate as many CCPs do not have an overlap in products. Also the number of examples would need to be high to reflect effects of cross margining between different products)
- Results of simple standardized stress tests: There are no standardizes stress tests defined in the regulation
- Uncovered credit losses and how they are allocated: It is not clear what is actually meant as from clearing there should not be any uncovered exposures

C. Closing

We hope that you have found these comments useful and remain at your disposal for further discussion. If you have any questions please do not hesitate to contact:

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