

Via E-Mail cpss@bis.org and fmirecovery@iosco.org

11th October. 2013

The Committee on Payment and Settlement Systems (CPSS) and
The Board of the International Organization of Securities Commissions (IOSCO).

Dear Committee and Board Members,

Re. Consultative report on Recovery of Financial Market Infrastructures (August 2013)

CCP12*, a global association of 32 major Central Counterparty Organizations, congratulates both CPSS and IOSCO, in their effort by the issue of this consultation that is intended to pursue the public policy objectives of enhancing the “safety and efficiency in payment, clearing, settlement, and recording arrangements, to limit systemic risk and foster transparency and financial stability”.

CCP12 recognizes the relevance for a FMI and for the Financial System to recover from a threat to its viability and financial strength, so that it can continue to provide its critical services without the use of resolution by authorities. CCP12 is conscious that despite an FMI’s risk management and recovery plan, it is possible that extreme stress could create a situation where an FMI cannot remain viable and that it may need to conduct an orderly wind down.

CCP12 fully supports the general terms of this report, that does not create additional standards, that expands on PFMI¹s consistently with FSB Key attributes, that sets out the actions of an FMI to address any uncovered credit loss, liquidity shortfall, capital inadequacy, or business, operational or other structural weakness, including the replenishment of resources and that provides the elements to other relevant stakeholders to prepare for extreme circumstances, reducing the uncertainty and increasing the probability that most effective tools will be used. It would highlight that the Recovery Plan should identify clearly at a minimum the critical services, the stress scenarios, the triggers and the tools² for recovery. The report includes a complete and very well described set of tools. In line with the report, CCP12 considers this is not an exhaustive list of tools, and that CCPs can design other tools according to the particular needs and regulatory environment. One of our Members suggested for example, the use of Portfolio Compression as

¹ CPSS-IOSCO Principles of Financial Infrastructures.

² also agree on the attributes that should be pursued in choosing the tools; that is that they are: comprehensive , effective, timely, reliable, transparent, have a strong legal basis, designed to provide appropriate incentives , have a smaller negative impact are generally more desirable, consistent with the FSB’s Key attributes.

an effective tool before auction in OTC derivatives markets in effecting risk reduction by taking out economically redundant trades. However to make this work, a CCP should have authority from clearing participants to run such compressions. As in other CPSS-IOSCO consultations, CCP12 would emphasize again that there is not a “one size fits all” solution since there are a lot of considerations for a CCP such as membership/participation, jurisdiction/legal requirements, products cleared, risk waterfall set up, etc.

It is important to mention, that some of the presented tools represent a challenge to be implemented. For example, capitalization is not easy to improve even in normal course. Used as a very last measure, this would burden shareholders with losses from business operations. Another one, initial margin haircutting is not too realistic from the legal perspective and may turn out to be capital intensive for the participants. Cash calls to Default Fund seem to be more advisable from the perspective of the participants risk management.

Our Association agrees on that the main responsibility of designing effective recovery plans remains on the FMIs and that this should be done ex-ante. However, authorities also play a key role from our perspective and they may need to be proactive to provide explicit guidance on how a given regulator will be involved so the CCP can appropriately plan CCP12 estimates that triggers to both recovery and resolution are quite important to be defined. The clearer the better, as potential negative systemic impact can be reduced. A CCP on “recovery” could erode the market confidence. It is important to remind that a default management is part of a CCP process and this does not necessarily imply that a CCP need to be considered in a recover status. In normal and extreme conditions considered under PFMI criteria, losses could be effectively allocated on the defaulted participant. The recovery process should therefore be started when the pre-funded and committed financial resources are exhausted or that according to the loss estimation they are likely to be consumed, precondition that should be arranged ex-ante. Secondly, we feel that, with the participation of authorities in each jurisdiction and considering the regulatory framework, the line between recovery and resolution should be clear determined. This would bring a better insight on the possible scenarios when recovery tools are not performing as expected.

During a recovery process, discretionary decisions could represent a challenge (and also a risk) from the legal perspective. CCP12 would be in favor of formalizing in each jurisdiction a Recovery and Resolution Regime. This would bring transparency and legal soundness which would contribute to the objectives of financial stability.

CCP12 would also like to provide the following recommendations and comments that are intended to point out some elements relevant to CCPs and to put under CPSS-IOSCO judgment to complement this report taking them into account.

Context: *The recovery tools should be transparent in order to allow those who would bear the losses and liquidity shortfalls to understand clearly how the allocation of the losses and liquidity shortfalls will be determined...* (Page 1).

Comment- We agree that it is in the best interest of the FMI to provide the elements to understand the allocation of losses to those who would bear them. Moreover, we consider that the key elements of the Recovery Plan, which includes the recovery tools and process, should be communicated in accordance to the criteria established in Principle 23 relative to the Disclosure of rules, key procedures, and market data.

Context- *Even where there is ex-ante agreement that a tool is available, there needs to be an appropriate balance struck between its automatic application in a given situation (which increases transparency and predictability) and discretion by the FMI to use its judgement.... (Page 1)*

Recommendation- CCP12 agrees with a balanced approach between tools available and discretion used. In a given situation where there's a need for a discretionary decision, the Recovery Plan should establish a process of discretionary decision taking. Discretionary decisions should be recorded and informed to the authorities without delay.

It would be also desirable that this report provides further guidance on how to use the discretionary criteria. FMIs should be conscious and prepare as possible for potential disputes arising from these types of decisions.

Context- *Tools for dealing with liquidity shortfalls can be separable from tools to deal with credit losses. Similarly, tools for establishing a matched book can be separable from tools to deal with credit losses.... (Page- 2)*

Recommendation- We consider important to establish in the Recovery Plan, a map of the considered tools that can be used to deal with the uncovered losses arising from each possible sources of loss (credit losses, liquidity shortfalls, custody and investment losses, business losses), the replenishment of financial resources, the re-establishment of a matched book and consider them separately to each context. It can be the case that a particular tool can be used as a mechanism to allocate losses from more than one source of loss; however the trigger and conditions of use can vary. Therefore, we consider that the guidance should generalize that the tools can be separable.

Context- *FMIs should have tools to replenish financial resources once losses caused by participant default have been allocated..... (Page 2)*

Recommendation- We consider that the replenishment of financial resources should not necessarily occur in a context of recovery.

It can be the case that where a participant defaults, mutualizables resources of the net have been exhausted. The CCP should be allowed to continue to provide its critical services without the use of resolution by authorities until the remaining Clearing Members replenish the resources, provided this is done under a reasonable timeframe.

We strongly suggest that triggers for both recovery and resolution are carefully designed. An FMI such as a CCP under a “recover status” could produce a negative impact to the market in terms of reliability and confidence. This is contrary to the promotion of a stable Financial System. We recommend that the report points out the relevance of declaring an FMI under “recovery status” and that the FMIs analyze the respective implications.

Context- . *Many of the commentators on that consultative report requested more guidance on what recovery tools would be appropriate for different types of FMI in different circumstances. This new report provides that guidance....* (Page 4 - 1.2.1)

Recommendation- We notice that most of the explicit references are oriented to CCPs (57 references), in the context of CCP12 we find this quite useful. However, other FMIs such as payment systems (1 reference), securities settlement systems (1 reference), trading repositories (0 references), CSD (0 references) are not explicitly referred.

It is important to clarify that the lack of references does not imply that the mentioned recovery cannot be applicable to FMIs other than CCPs. However we consider important to relate those tools that can be particularly appropriate for different types of FMI, considering the diversity of risk profiles. For example, in some scenarios particular types of FMIs could be more likely to become insolvent due to losses arising from operational failures, or due to sudden legal claims (such as TRs, SSS and CSDs). If guidance is provided considering the diversity of FMIs, a broad global consensus could be achieved.

CCPs are closely linked to all types of FMIs and other linked CCPs. It is very important that these infrastructures also have effective recovery plans.

Context- *Owners of the FMI, who benefit from the profits of the FMI, may be exposed to a share of the losses in a manner consistent with the extent of their investments and the FMI's legal basis.. (Page 15 - 3.3.7)*

Recommendation- We fully agree. As stated in the rest of the report, it is quite important to establish that the scheme of loss allocation gives the right incentives for a closed follow up of the FMI risk management policies and procedures and for controlling the risk that the participant generates to the FMI.

Context- *To the extent losses are allocated to direct participants rather than indirect participants, then ... increased incentives to become (or remain) indirect participants, which in itself may carry potential risks. Consistent with Principle 19, an FMI should identify and manage any risks it may face from the balance between direct and indirect participation. (Page 16 - 3.3.12)*

Comment- We fully agree with this reasoning; incentives to become (or remain) indirect participants should be mitigated.

Context- *... a potential cash call would represent a controllable exposure if the maximum size of the cash call is either (a) capped by a fixed amount or (b) tied to and limited by the absolute value of the participant's directly controllable activity ... In contrast, a potential cash call could represent an uncontrollable exposure if the maximum size of the cash call is neither capped nor limited by the participant's directly controllable activity or position. (Page 17 - 3.5.3)*

Comment- We completely agree and note that the cash calls should be embedded in a FMI's rules.

Context- *To deal with a defaulter's outstanding positions, a CCP should auction these to direct participants or to third parties who could clear such positions through direct participants. The CCP's rules could provide incentives for successful bidders on unmatched contracts. (Page 24 - 3.9.3)*

Recommendation- We consider important to mention that by establishing the right incentives to bid in auction, CCPs should also prevent against any abuse by the market participants in the auction process or in the process of establishing a matched book.

CCP12 appreciates your consideration of this submission and looks forward to working with you to advance the steps being taken for a safer CCP Industry.

Sincerely,

Siddhartha Roy
Chair,
CCP12 – The Global Association of Central Counterparties

Attachments: Annex 1: List of CCP12 Member Organizations

*** About CCP12**

Formed in 2001, CCP12 is a global association of 32 major central counterparty clearing house organisations across Africa, the Americas, Asia, Australia and Europe. CCP12's mission is to collaboratively share information, support development of standards and liaise with regulators, industry groups and global market users to foster dialogue on areas of mutual interest and concern, and to promote best practices in CCP risk management and operations.

For further information/clarification about this submission, please contact the current Chair, Mr Siddhartha Roy, Chief Risk Officer, The Clearing corporation of India Ltd., Mumbai at +91 22 6154 6411 or via sroy@ccilindia.co.in

ANNEX 1

List of CCP12 Member Organizations

CCP-12 Member Organization	Geographic Identifier
ASX Limited (ASX)	Australia
BM&F Bovespa (BM&F)	Brazil
Cassa di Compensazione e Garanzia S.p.A. (CC&G)	Italy
Contraparte Central S.A. (CCLV)	Chile
Cámara de Riesgo Central de Contraparte de Colombia S.A. (CRCC)	Colombia
CME Group (CME)	USA
The Clearing Corporation of India Ltd. (CCIL)	India
TMX Group (TMX)	Canada
Depository Trust & Clearing Corporation (DTCC)	USA/UK
Dubai Commodities Clearing Corporation (DCCC)	UAE
Gre Tai Securities Markets (GTSM)	Taiwan
Grupo BMV	Mexico
Eurex Group	Germany
Hong Kong Exchanges & Clearing Ltd (HKEx)	Hong Kong
Indian Clearing Corporation Limited (ICCL)	India
Intercontinental Exchange (ICE)	UK
Krajowy Depozyt Papierów Wartościowych (KDPW)	Poland
Korea Exchange (KRX)	South Korea
LCH Clearnet Group Ltd. (LCH)	UK
Mercado de Valores de Buenos Aires S.A. (Merval)	Argentina
NASDAQ OMX (NASDAQ)	USA/Sweden
National Securities Clearing Corporation Limited (NSCCL)	India
National Clearing Center (NCC)	Russia
The Options Clearing Corporation (OCC)	USA
Johannesburg Stock Exchange (SAFCOM)	South Africa

CCP-12 Member Organization

Shanghai Clearing House (SHCH)

Singapore Exchange Ltd (SGX)

SIX X-clear (SIX)

Taiwan Futures Exchange (Taifex)

Taiwan Stock Exchange (TWSE)

Tel Aviv Stock Exchange (TASE)

Japan Securities Clearing Corporation &
Tokyo Stock Exchange, Inc.**Geographic Identifier**

China

Singapore

Switzerland

Taiwan

Taiwan

Israel

Japan

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