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EACH RESPONSE TO THE CPSS-IOSCO CONSULTATIVE REPORT ENTITLED “RECOVERY OF FINANCIAL MARKET INFRASTRUCTURES”

EACH, the European Association of Central Counterparty Clearing Houses, welcomes the opportunity to respond to the CPSS-IOSCO consultative report on recovery of Financial Market Infrastructures (“the Report”).

EACH welcomes the differentiated approach for Financial Market Infrastructures (FMIs), as in our view the recovery approach for banks cannot and should not be applied to FMIs. Different types of FMIs may require also different requirement (e.g. CCPs vs. CSDs). EACH’s comments to this consultation are focussed on the recovery of CCPs.

Furthermore EACH believes that every CCP possesses a specific regime for addressing member default risks in the form of a default waterfall. This waterfall was developed to match the specific business and circumstances of that CCP and its participants. Following the definition of recovery in paragraph 1.1.1 of the report, EACH welcomes that most measures of the default waterfall are not subject to recovery. Given the negative connotation of the concept of “recovery” and the potential negative impact for a CCP and the financial markets in general if a CCP is considered to be “in recovery”, the start of the recovery process should preferably kick in at a later stage of the waterfall, i.e. when all pre-funded and committed financial resources have been exhausted or have become unlikely to be sufficient.

EACH understands resolution as a regime which occurs before insolvency and which is implemented by public authorities. EACH is of the opinion, that the adequacy of a resolution regime depends strongly on the local insolvency law and therefore there is no “one size fits all” solution (e.g. a CCP holding a banking licence gets exemption from banking regulation on resolution in favour of regulation of FMI resolution). Provisions, which are enforceable in one market under recovery, can be implemented in another market only under resolution or insolvency. Therefore EACH welcomes the flexibility for individual solutions as outlined in the report.

EACH would like to emphasize the following statements:

- a) EACH is supportive of the recovery arrangements as set out in the report. It also strongly supports the objective of ensuring that the FMI can continue to provide its critical services without requiring the use of resolution powers by authorities. Furthermore EACH supports IOSCOs Principle of retaining a balance between automatic implementation of the recovery tools and discretion of the CCP (paragraph 2.3.6 and 2.3.7 of the report).

- b) Whilst it is appropriate for CCPs to ensure they have the powers required to implement comprehensive recovery tools, such power may not be fully in the control of the CCP. Governments should ensure that legislative and regulatory barriers which prevent a CCP from putting in place such comprehensive recovery arrangements are removed, and not put in place in future.
- c) EACH considers that within each jurisdiction, full clarity must be provided as to where the boundary lies between recovery and resolution and FMIs should be empowered to perform their recovery plans before any resolution is initiated by the authorities. Without full clarity, the effectiveness of a CCP's recovery arrangements will be jeopardised, because clearing members, on whose participation recovery depends, may seek to protect themselves from the unquantifiable risk of ad-hoc intervention from public authorities. This could lead to undesirable outcomes before resolution commences.
- d) In order for recovery arrangements to be comprehensive, it is vital that they are sufficiently broad and flexible to be able to accommodate conditions which are by their very nature difficult to foresee. There are number of proposals included in the report which require an unrealistic degree of specificity of the circumstances, parameters, details and triggers for particular resolution tools. For example, the documentation of stress scenarios, required in paragraph 2.4.3, may be helpful for illustrative purposes, but it should be acknowledged that will not be, and should not be, exhaustive. Similarly, the analysis of each of the recovery tools, required in paragraph 2.4.9, will inevitably depend on individual circumstances, and evaluation prior to such circumstances being known will inevitably be of limited effectiveness. For similar reasons, testing of recovery arrangements, as required in paragraph 2.3.11, will be of limited benefit without knowledge of the particular circumstances.
- e) The report states in paragraph 2.4.14 that where there are links between FMIs, the design and implementation of one FMI's recovery plan may impact the other FMIs. The point should be made that, although such impact may indeed occur, the aim should be to prevent it as much as possible.
- f) Managing a member default is inherent to the role of a CCP. Every CCP therefore puts in place arrangements with its members to ensure that sufficient resources are available to manage such a member default under the most extreme scenarios. The process of default management precedes recovery. Where the boundary between the two lies is open to discussion. The report puts this boundary when
 - (a) pre-funded resources have been exhausted or
 - (b) it has become unlikely that they are sufficient (paragraph 2.4.5),so before the use of any agreed assessment rights of the CCP but after the pre-funded resources required under EMIR. Given the negative connotation of the concept of "recovery" and the potential negative impact for a CCP and the financial markets in general if a CCP is considered to be "in recovery", the start of the recovery process should preferably kick in at a later stage of the waterfall, i.e. when all pre-funded and committed financial resources have been exhausted or have become unlikely to be sufficient.
- g) The report provides an overview of recovery tools that FMIs may include in their recovery plans. EACH fully agrees with the approach chosen in the report that
 - (a) each FMI should consider when and in what combination or sequence the application of particular recovery tools would be appropriate and

(b) that the recovery tools presented in the report should not be considered as an exhaustive list.

It is the view of EACH that each FMI should agree with its participants what are the appropriate default management and recovery tools bearing in mind that the toolkit must be flexible enough to allow it to be deployed to address even an unforeseeable string of events. Such a toolkit approach provides transparency to the FMI's participants at the same time as providing necessary flexibility to accommodate the inherent uncertainty. It would be undesirable for any CCP to be required to implement any recovery tool automatically, i.e. for implementation of the recovery tool to be mandatory irrespective of the circumstances of the particular situation.

- h) Variation margin gains haircutting can serve as a robust tool for a final loss allocation in swaps and futures markets. However for cash markets or if combined with an options market other approaches have to be developed..
- i) One recovery tool which is omitted from the report is the possibility of a temporary market suspension. We believe that in certain circumstances, such a suspension of services, or 'false weekend', could be a permissible tool, e.g. to allow time for recapitalisation.
- j) We agree that continuity of services is a key objective. We do not believe however that this objective should over-ride all other considerations, including stability of the financial system and protection of assets. There may be circumstances, if other measures are unsuccessful, that termination of a particular product set / final loss allocation mechanisms may be appropriate. Such tools should not be precluded as a mechanism of ultimately restoring a balanced book, possibly as a means of restarting the market or in order to continue to provide services in associated markets. Such tools also have a role in ensuring that the recovery process is comprehensive.
- k) State or government bailouts have to be explicitly excluded from CCPs' recovery and resolution plans. Any potential for a bail-out of CCPs harms the CCP's risk management, as it creates misaligned incentives for CCPs and clearing members.
- l) Participants, Clearing Members AND their clients need to be aware of all risks and liabilities ex ante. No forced ex post loss allocation should be implemented. Clear and predefined limits to all liabilities should be known to all participants ex ante. While a CCP's recovery and resolution plan has to encourage both clearing members and clients to support the CCP during the default management process, liabilities have to be limited. Clearing members must be incentivised to support the CCP in a crisis, as their exit inevitably increases the burden on the remaining membership.
- m) EACH strongly supports the view that it is beneficial to share losses from credit risks and liquidity shortfalls as widely as possible so as to minimise the loss that each entity has to bear (paragraph 3.3.5). Minimising the loss per entity also minimises the risk of triggering the default of another institution and the systemic contagion that could result from that. The market as a whole benefits from contributions to a CCP's mutualised default fund, and it is not inappropriate that the market as a whole contribute to recovery measures following the depletion of the default fund. Therefore a priori public authorities should not rule out loss allocation to clients as well as clearing members.

EACH would welcome the opportunity to discuss the contents of its response with you, particularly if you require any clarification about the contents of this response.

Should you require further information, please do not hesitate to contact the undersigned.

Yours sincerely,



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EACH Chairman



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About EACH

European central counterparty clearing houses (henceforth CCPs) formed EACH in 1992. EACH's participants are senior executives specialising in clearing and risk management from European CCPs, both EU and non-EU. Increasingly, clearing activities are not restricted exclusively to exchange-traded business. EACH has an interest in ensuring that the evolving discussions on clearing and settlement in Europe and globally, are fully informed by the expertise and opinions of those responsible for providing central counterparty clearing services.

EACH has 22 members:

AthexClear S.A.	ICE Clear Europe
BME Clearing S.A.	IRGiT S.A. (Warsaw Commodity Clearing House)
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CCP Austria	KELER CCP Ltd
CME Clearing Europe	LCH.Clearnet Ltd
CSD and CH of Serbia	LCH.Clearnet SA
ECC (European Commodity Clearing AG)	NASDAQOMX Clearing AB
EMCF (European Multilateral Clearing Facility)	National Clearing Centre (NCC)
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	Oslo Clearing ASA
	SIX x-clear AG

This document does not bind in any manner either the association or its members.

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