



11 October 2013

Secretariat
Committee on Payment and Settlement System
Bank for International Settlements
Sent by e-mail to cpss@bis.org

Secretariat
Technical Committee
International Organization of Securities Commissions
Sent by e-mail to fmirecovery@iosco.org

Re: Consultative report – Recovery of financial market infrastructure

Dear Committee members,

Japan Securities Clearing Corporation (hereinafter “JSCC”) appreciates the opportunity to comment on the Consultative report “Recovery of financial market infrastructure” published on 12 August 2013 by CPSS/IOSCO.

Among the issues raised in the report, JSCC would like to submit several comments as follows.

【Comments on “most effective and comprehensive recovery tool”】

We think desirable tools and desirable combination of tools are different by product or by the attribute of parties participating in transaction. As a conclusion of ours, adoption of variation margin haircutting and complete tear-up is effective and comprehensive for OTC derivatives. On the other hand, with respect to listed products, adoption of uncapped cash calls on participants is effective and comprehensive as long as risk of additional cash calls is controllable by participants.

For listed derivatives or cash products market, generally in which numerous individual investors are involved, if variation margin haircutting or tear-up are applied, it would be envisaged that extensive and significant impact would be factually given to the entire society. In other words, imposing variation margin haircutting or tear-up on individual investors, who comparatively lack ability and measure to manage such an extreme risk, could lead to the de facto “disruption of the market” through serious deterioration of the credibility of the market.

While we recognize that policy objective of CPSS-IOSCO/FSB on FMI's recovery/resolution plan is “*pursu[ing] financial stability and allow for the continuity of critical FMI functions without exposing taxpayers*”¹, we are deeply concerned that such de fact disruption of the market is another form of outcome which imposes cost burden on taxpayers.

From a pragmatic viewpoint and for a number of reasons below, we think it can be possible to design a comprehensive and controllable recovery framework for listed products, where despite uncapped cash calls are imposed on participants, maximum losses attributable to the cash calls will be measured and controlled:

- i. If percentage variance in price and number of bankrupt companies stochastically assumed under a certain stress scenario are clearly disclosed to participants, and total default fund requirement is calculated based on the said stress scenario, and then individual default fund requirement (pro rata allocation for each participant in line with respective position risk) is presented to the participants, they could clearly grasp the amount they need to incur respectively when the stress scenario becomes the reality. Also, with the said stress scenario and the requirement under the scenario being used as the benchmark, the probability of occurrence of more stressed scenarios and the additional requirement in respective cases can be measured. (Note that CCP would be responsible for disclosing necessary information as much as possible, within the allowable range, in order to enable participants to measure such parameters.);
- ii. Since in view of the past default data, there has not been a single case where price fluctuated more wildly than any of the stress scenarios assumed by CCP, the word “uncapped” or “unlimited” is almost metaphysical for listed products which are in general one of the most liquid instruments;
- iii. Participants could continuously measure potential risk size by closely monitoring the total clearing fund requirement and pro rata allocation for each of them. Also, as case may be, they should be able to take certain self-help measures to compress respective position risk so as to reduce such potential risk size; and

¹ Paragraph 1.1 of the Appendix I “Annex to the Key Attributes: Financial Market Infrastructure (FMI): Resolution of FMIs and Resolution of Systemically Important FMI Participants” published by the Financial Stability Board (FSB) on 12 August 2013.

- iv. Participants could participate in the governance process of CCP concerning the institutional designing, in order to have CCP ensure necessary improvements in institutional framework and environment for making the above measures workable. CCP is required to design such governance interface.

Moreover, in light of economic outcome, loss amount in total imposed on participants by means of uncapped cash call would be equal or less than the loss amount in the case of CCP's bankruptcy² as long as the amount of the additional cash call is calculated from participants' exposure to the CCP. Therefore, when considering capital charges on exposure to CCP, discriminatory treatment should not be given to CCP with uncapped cash call simply because that CCP employs uncapped cash call.

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² Taking legal and administrative costs in the case of bankruptcy into consideration, participants' economic outcome in the case of CCP's bankruptcy is usually worse than that of pre-arranged uncapped cash call.