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,

The Clearing Corporation of India Ltd, Mumbai, India
Response to CPSS 109 : Consultative Report on Recovery of Financial Market Infrastructures (August 2013)

We refer to the August 2013 Consultative Report on Recovery of Financial Market Infrastructures published on the BIS website and congratulate CPSS & IOSCO for publishing a comprehensive report which is very clear in intent. The five tools listed in the report will serve as an ideal ready reckoner for the FMI planning its recovery process. It has also extended the understanding on the subject and brought the distinction between recovery and resolution in clear focus.

2. We operate in India as a CCP for OTC financial market products since 2002 as an authorized Payment & Settlement System Service Provider authorized by Reserve Bank of India, the central bank of India. We presently provide CCP clearing for mainly institutional trades in Government Securities, Foreign Exchange – both spot and forward trades in Rupee/US Dollars, trades in domestic money market through our own product Collateralised Borrowing & Lending Obligation (CBLO). We are also in the process of offering CCP clearing of Indian rupee denominated trades in Interest Rate Swaps by using a trade data warehouse for such swaps created by us in Aug 2007.

3. Although the report is comprehensive, we have a few suggestions to make it more effective:

(i) The Report appears to be focussed almost entirely on recovery of CCPs and by extension to SSSs. The recovery of other types of FMIs has not been discussed in detail e.g. a TR can become insolvent due to non-recovery of costs or due to sudden legal claims from failure to provide data security. Similarly a Payment System can suffer huge loss from operations failure. If separate guidance in regard to recovery planning processes of these types of FMIs is provided, it will represent broad global consensus and may help the FMIs and their Regulators to develop appropriate Recovery Plan.

(ii) A CCP in recovery will have stigma attached and thus will have to operate with handicap. If the problem has origin in participant default, it will be necessary to allow entry into recovery stage only after all default handling related activities and incidental loss allocation have been completed.

(iii) A CCP in recovery can be subjected to legal challenges, specially in respect of actions where discretion is exercised due to unforeseen situation. This could halt the process of recovery. It would be desirable to institutionalise a Recovery & Resolution regime in each jurisdiction which acts against any frivolous action and allows equitable resolution, if required, with transparency and in keeping financial stability objective in focus.

(iv) Although discretion in respect of the order or manner in which the recovery tools would be exercised would have to be with the knowledge of Regulators, for the sake of stakeholders having more clarity, it would be desirable to lay down some guidance on how to use the discretion. Independent Directors with required skill sets may be the fulcrum around which such decision making could be done. The rationale behind such decision making should be duly recorded and forwarded to the regulator without any loss of time. Board of Directors of the FMI should review the decision as quickly as possible thereafter.

As exercising such discretion to some extent would be inevitable in almost all cases of recovery exercise and thus would have the potential to cause disputes, the transparency and governance around the process assumes considerable importance.

(v) The document rightly specifies the need for the FMI to include provisions to recapitalise after losses and have adequate assessment powers (paras 2.4.8 and 3.5.2). However, the proposal in the draft consultative paper on "Capital treatment of bank exposures to CCPs"(BCBS 253) speaks about capital provisioning on such potential liabilities. If the commitments by clearing members to contribute to the Default Fund are taken into account for capital treatment, this would act as a deterrent to attract more capital and make it difficult to include such a provision in the recovery plan.

(vi) An FMI is not going to find it easy to attract capital even in the normal course given that it would have restrictions on its pricing and revenue model, and possible caps on dividend pay-outs. In such a scenario, it would be unfair to burden the shareholders with losses from normal business operations except as the very last measure.

(vii) Initial margin haircutting is not advisable from the legal, equity and operational perspective for the CCP and may prove capital intensive for the participants. It is therefore an unviable option. Even from the perspective of risk management by the participants, getting commitment to contribute additional amounts to Default Fund through Assessment Process would be more reasonable. As the participants will have to get back collaterals placed as Initial margins while depositing funds towards additional contributions to Default Fund, the possibility of non-recovery in this case would be low.

(viii) Role of Regulator: The regulators will provide support to carry out recovery program of MFIs. In case of CCPs, this could even be in the form of collateralised liquidity as bridge finance to manage interim liquidity shortfall. As the Recovery planning should be an exercise which needs to get into specifics, Regulators may also be indicating the steps they are likely to take under various scenario so that these could also be considered for drawing up Recovery Plan.

(ix) It is now an accepted position that Portfolio Compression can play a very important role in OTC derivatives markets in effecting risk reduction by taking out economically redundant

trades. This attribute of Portfolio Compression can be used by a CCP as an effective tool before auction of a large trade portfolio of a Defaulter Participant. This will ensure that the trades auctioned are only about 10 to 15% of the outstanding trades and even if those are required to be terminated through allocation, cases of such allocation would be much lower in volume. To make this work, a CCP should have authority from clearing participants to run a Portfolio Compression at the time of Default handling involving trades of all participants based on CCP's valuation of the trades and risk parameters like PV01 etc.. This would also help in ensuring that financial stability objective is also better served while handling Default.

4. If any *information/clarification about this submission is needed, please feel free to contact Mr Siddhartha Roy, Chief Risk Officer, The Clearing Corporation of India Ltd., Mumbai, India at +91 22 6154 6411 or via sroy@ccilindia.co.in or Mrs Indrani Rao, Chief Forex Officer, The Clearing Corporation of India Ltd., Mumbai, India at +91 22 6154 6461 or via irao@ccilindia.co.in*

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