



Thomas Murray
Data Services

Klaus M. Loeber
Head of Secretariat
Committee on Payment and Settlement Systems
Basel

and

David Wright
Secretary General
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Madrid

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CPSS-IOSCO public consultation on quantitative disclosure standards for CCPs

Response submitted by email to cpss@bis.org and qdisclosure@iosco.org.

Dear Messrs Loeber and Wright,

The firm of Thomas Murray wishes to thank CPSS and IOSCO for the opportunity to comment on the proposal for adding quantitative disclosure standards for CCPs as a complement to the qualitative information to be prepared in accordance with the Principles for Financial Market Infrastructures ("PFMIs").

CCPs are a diverse group of entities being asked to assume unprecedented responsibilities in reducing risk in the global financial system, in particular as regards derivatives instruments. The firm believes that additional quantitative disclosure requirements are a good idea, and that the information released to the public will add to evaluations of risk positions, and therefore provide some additional certainty to the marketplace.

The firm

Thomas Murray is a private firm registered in the United Kingdom, and founded 20 years ago. It is owned by 80 individual investors; there is no institutional tie of any kind, assuring the independence of viewpoint that is essential for credible analytical and advisory services.

Somewhat unusually, the firm's business is devoted solely to capital markets infrastructure institutions, and its analyses cover 430+ such establishments in more than 80 countries. 75 persons work for the firm, and we endeavour to provide current, detailed information to our clients. The question which led to the founding of Thomas Murray was global custody, and from there, encouraged by its clients, the business coverage spread by geography and line of business. Today the firm's analytical coverage includes central securities depositories, custodians (global, national, and sub-custodian), settlement houses, and registrars, as well as clearing houses.

Thomas Murray's CCP assessment programme represents a considerable deepening of the firm's expertise on the subject of clearing. It was launched at the beginning of 2012 at the request of global banking clients, and with their backing. It has been clear since the 2009 G20 Pittsburgh summit that the policy expectations in terms of capital markets risk management were changing considerably in the clearing field and at the same

time the financial services industry more broadly has been evolving post-2007. Our clients asked for the firm's assistance in projecting forward what the commercial outlook might be when the regulatory changes then being written would come into effect; and also what their increasing capital requirements might be as participants.

Our colleagues elaborated a detailed questionnaire on central clearing. It did so with input from official sources, including CPSS - IOSCO and the Basel Committee of Banking Supervisors, in order to be sure that the assessments would provide the information that clearing houses and their members would need to generate for both risk management and capital provision. Thomas Murray commented in July 2011 on the public consultation preceding the establishment of Principles for Financial Market Infrastructures; our firm's work was cited at length in the World Federation of Exchange's submission for that consultation, too. Today, we find the PFMI's useful for our reviews. The CPSS-IOSCO policy objectives are central to this firm's work with infrastructures.

The CCP risk assessment programme today covers in near real-time 26 CCPs. The firm's research is based on publicly available information, with commentary provided by clearing members and the clearing houses themselves when they accepted the firm's invitation to do so. To make the information comprehensible and comparable across institutions, it has been gathered and presented according to six risk themes:

- Counterparty
- Treasury and liquidity
- Asset safety
- Financial
- Operational
- Governance

In addition, the firm has begun to publish a transparency index that shows how much information required for these assessments are made available to the public.

Thomas Murray believes that this extensive knowledge of financial markets institutions generally, and of CCPs in particular, may give weight to the comments which follow.

General comments on the current consultation

At the outset, CPSS-IOSCO underscore the point that quantitative disclosures cannot be used alone to understand the workings of a central counterparty. They would fill out the picture provided by the qualitative PFMI's, as the disclosure matrix puts it.

Such additional precise reporting will enable the public to learn a good deal more about CCPs. Additional transparency matters for confidence as well as more effective risk management, especially so at this time of transforming change for clearing. Given the complexity of this environment and the diversity of clearing house circumstances, however, the firm of Thomas Murray would not yet say that this reporting will enable the public or the authorities to understand them as well as we might wish. Knowing more is not yet gaining full understanding. The firm's understanding of CCPs leads us to considerable circumspection. We have been finding that the CCPs' individual ways of working are substantially different from one another, and they cannot easily be pinned down as a group.

Too much is changing commercially and in terms of law and regulation for CCPs to drop one's vigilance. Most especially, the OTC derivatives question is the most important variable here, impacting clearing houses differently. CCPs cannot and will not be the single easy answer to the risks inherent in bespoke or even standardized OTC contracts whose counterparties resist trading in the public markets. On this matter of less well knowable counterparty risks being introduced into the CCP arena, the firm of Thomas Murray remains guarded as to the consequences.

Other questions come to mind: how will the qualitative and quantitative disclosures be presented? Is it CPSS-IOSCO's intention that they will be combined into a single, holistic view of the CCP? Or will the authorities and the public have to do such analyses on their own? Also, will there be a central reporting point of these separate – or these combined – disclosures that would be accessible to the public? If the quantitative data are designed to complement the evidence supporting observation of the Principles, how will the methodology for assessment be (re)developed?

The methodology for compiling this information will go a long way towards adding to the transparency of clearing house workings, which is the purpose behind this consultation. The firm would have questions about assuring comparability of quantitative data, because we are finding this hard in our own assessments. The reporting channel itself will matter, as will the way the reports are kept in central form. We raise these points to guide CPSS-IOSCO towards the best possible outcome, not to dissuade them from pursuing this course.

We can imagine that there will be competitive issues among clearing houses when it comes to releasing some of this information, much of which goes to the heart of their business models and therefore their earnings. In responding to this, if the authorities go ahead with the disclosure requirement while not making all this additional information available to the marketplace, CPSS-IOSCO would do well to inform the public even more carefully on the methodology the national authorities will be using to assure the operating safety of these infrastructures. This will be an important factor in maintaining confidence in the safe operations of institutions that are, indeed, too big to fail.

Timeliness matters in markets which move swiftly. We note that not all PFMI self-assessments are being reviewed at the same speed, which already creates information imbalances. We ask that a timetable be established for the qualitative/quantitative reports that respect the common information needs of the marketplaces and their supervisors.

Finally, we are aware that CPSS-IOSCO Principles are global best practice, but that self-assessments are not compulsory, or at least not on the same timetable. It is in all our interest to make sure that participation is as attractive as possible, in order to avoid finding that some CCPs opt out of this process.

Conclusion

In October 2013, IOSCO made its first public pronouncement on key risks it sees in the capital markets. CCPs made the list, and they are now considered by IOSCO as institutions which are “too big to fail.” Thomas Murray would agree. Therefore, moving ahead quickly with quantitative disclosures to complement the information contained in the PFMI assessments makes very good sense to the firm.

Our word of caution comes from how the information will be used, and above all the wish to be certain that the authorities and the users of the world's capital markets not drop their vigilance. While much netting of positions is being achieved for standardised OTC instruments, we nonetheless have in mind that there is also the countervailing process of risk transfer to the CCPs. It is hard to see the net result between risk concentration and reduction through netting. Whatever the balance of forces there, this firm is certain that final result is not risk elimination.

The firm's detailed commentary on each of the PFMIs follows point by point in annex.

We remain respectfully yours for questions you may have.

Sincerely,



Thomas Krantz
Senior Advisor Capital Markets

CC: Simon Thomas, Jim Micklethwaite, Tim Reucroft, Alex Harborne, Xiang Li, and Aaron Brown, TM

Thomas Murray comments on the specific points raised by CPSS-IOSCO

Principle 4, credit risk

As users of the information generated by PFMI assessments, the firm would find it very helpful if CPSS-IOSCO could provide a clear definition of "more-complex risk profile," and, if possible, publish a list of financial instruments that are considered to have a "more-complex risk profile." This would help CCPs to ascertain whether they are subject to Cover 1 or Cover 2, especially in those cases where the regulator has not specified this in their regulations, and make the corresponding disclosures.

Some CCPs already make public their stress-test information. We would not think that this disclosure requirement would create a significant extra burden on all CCPs. They produce this information for their internal risk management purposes, in any case.

In addition, we believe data relating to the stress scenarios could be valuable to market participants, such as the number of scenarios used in the stress testing.

Principle 5, collateral

Haircuts change in response to market conditions, but the fundamental outlines evolve more slowly. We note that post 2007, much with respect to haircuts has changed. A recent example was the American federal debt ceiling blockage in Congress, which led HKCC to increase their haircut rate on U.S. Government Treasury bills. While market liquidity in asset classes can change rapidly, the basic outline for calculating haircuts does not need to be more quickly adapted. Disclosing the haircut methodology quarterly is sufficiently frequent, in our view.

Principle 6, margin

Attempting to collect specific, comparable information on margin may prove somewhat futile in the end, because in our experience with the universe of CCPs there are simply too many different methodologies being employed, all with their specific inputs and outputs. There is also the factor of different CCPs clearing different products. It serves little purpose to compare margin when the products are generally not comparable. If CPSS-IOSCO were to find value in requesting specifics on these kinds of information, it would have to take care that the users of the data should not draw incorrect conclusions.

The firm would strongly support requesting disclosure of the results of back-testing of initial margin requirements, which seem to us to be of fundamental interest to the marketplace and its overseers.

If the data are collected, however, we believe that monthly reporting would be sufficient. This should not pose an undue burden on the CCP, because we understand that they would have this information readily at hand. This collection and disclosure of more information on margining would indeed enable users of the data to make detailed analyses. We would hope only that they would appreciate the difficulties of comparing these from one CCP to another.

Opinions even within Thomas Murray differ as to the usefulness of the disclosure of information on intra-day margin calls. On the one hand, it could signify that the CCP is under margining the cleared contracts and has to call more margin as the market moves from the previous day. On the other, it could be that the CCP is issuing intra-day calls in order to cover risk taken on through the course of daily clearing. The first of these possibilities would be a cause of great concern; the second would represent a very risk-averse margining model.

In addition to the non-cash collateral posted by clearing members, how much, where applicable, is held in the form of bank guarantees? This is important, because there are clear regulations, at least under EMIR, with regard to the use of these back-up supports for margin.

As to point four under this Principle, we wonder if this is asking for correlations between two products, or the actual margin offsets offered by the CCP. We believe that clarification would avoid misunderstanding, and help to ensure that the data provided are comparable across CCPs.

Principle 7, liquidity Risk

We find it very important to collect hard liquidity data for a CCP. Management may have to deal with the default of a clearing member suddenly, at any time, and in such a circumstance it must have access to liquid resources. Default events are never well timed, by definition.

In our view, requesting disclosure on liquid resources would not necessarily cause a CCP to divulge sensitive information. Other than cash on deposit at the central bank, which should be stated as such, a CCP might simply detail the names of the banks where cash accounts are kept, which offer committed lines of credit, committed foreign exchange swaps, committed repo facilities, together with highly liquid collateral held in custody and as investments. The simple amounts by category might suffice. The difficulty here, however, is that not all financial institutions are of equally solid standing these days. Should yet more details on these relationships be required for disclosure?

Principle 8, finality of settlement

With respect to derivatives instruments which are cash settled, finality of settlement is as important for completing these transactions as it is for cash-traded securities. We suggest that this be specified.

Principle 13, default rules and procedures

An important statistic, and one that is mentioned in the qualitative PFMI, is the clearing member's additional contribution [replenishment] to the default fund, should it be fully utilised. As well as the number of times a non-defaulting clearing member will be required to replenish the default fund, it is important to know the period this lasts for (i.e., after 30 days following the default, will the replenishment number be re-instated?)

Alongside this, as regards the CCP's skin-in-the-game requirement, how long following it being utilised must it be re-instated? To take but one example, EMIR states that this should be one month from the notification by the CCP to the competent authority. We note, however, that for other countries this may vary.

In our view, disclosures on historical defaults would also be informative. We would suggest that CCPs disclose data for their historical default(s), if any, when they make their quantitative disclosures for the first time. Going forward, every time an event of default occurs, they would then report it on an ad-hoc basis.

Principle 15, general business risk

One concern this firm has is that a considerable number of CCPs are not separate legal entities – in this segment of capital markets infrastructures, one finds entities that are both a CSD and a CCP, and we also find CCPs operated in-house by the exchange. In such cases, the financial data of the whole entity is unlikely to provide sufficiently detailed information about the clearing business, though this is where so much of the risk is concentrated. Therefore, we believe that the PFMI quantitative financial disclosures should focus on the clearing segment in order to provide the information the marketplace and authorities need, and ask that the more complex institutions leave aside the figures associated with trading or depository.

The firm would appreciate clarity with regard to exactly what items on the accounts constitute 'liquid net assets funded by equity'. Since liquidity is a function of the market, it is subject to abrupt changes in its availability. This was most recently demonstrated by the near-default of the United States, which affected the

liquidity of its government debt, an instrument that is essentially viewed in the same light as cash. A CCP's understanding of liquid net assets may be very different from that of its regulator and / or CPSS-IOSCO.

The semi-annual reporting of general business risk information should be sufficient, in our view. We suggest six months due to the common requirement of auditing financial statements with such periodicity. Also, we believe that a common standard for CCPs is that their resources must cover six months of operating expenses. A more frequent requirement for that figure would, in our view, not be necessary given the relative stability of profit and loss statement categories in infrastructure institutions.

Principle 16, custody and investment risk.

The firm would think it important for the markets and its overseers to have disclosure on the amount and value, if any, of exchange-traded and OTC derivatives used in relation to the investment policy. The firm recommends that any such positions be broken out of the "other" category under 16.2.

Principle 18, access and participation requirements

As concerns metrics for individual members, in this firm's opinion the simplest solution would be to assign a number to the clearing member, i.e., 1, 2, 3, etc. That way, important information regarding concentration can be viewed, without releasing confidential information surrounding each individual clearing member. This should be true for any other potentially sensitive matters surrounding the disclosure of confidential information that may expose a clearing member's information.

Principle 19, tiered participation arrangements

We are concerned that different CCPs may have different interpretations of the term "clients." It would be helpful to clarify whether or not 'clients' include non-clearing members (NCMs). If not, the CCPs should disclose their number of NCMs separately.