October 4, 2022

Secretariat to the Committee on Payments and Market Infrastructures
Secretariat to the International Organization of Securities Commissions

Submitted via email to: cpmi@bis.org; and consultation-05-2022@iosco.org

Re: CR05/2022: A discussion paper on central counterparty practices to address non-default losses

ABN AMRO Clearing Bank N.V., Barclays, BlackRock, Inc., Citigroup Inc., Goldman Sachs Group, Inc., JPMorgan Chase & Co., T. Rowe Price, and The Vanguard Group appreciate the opportunity to submit comments to the Committee on Payments and Market Infrastructures ("CPMI") and the Board of the International Organization of Securities Commissions ("IOSCO") discussion paper on central counterparty ("CCP") practices to address non-default losses ("NDLs") ("Discussion Paper").[1]

Our white paper, *A Path Forward for CCP Resilience, Recovery, and Resolution*, first published in October 2019 with now 20 signatories across buy-side and sell-side firms ("White Paper"), discussed the need for policymakers to require CCPs to be responsible for NDLs, supported by appropriately sized regulatory capital requirements.[2] We applaud CPMI-IOSCO's commitment to advance industry efforts and foster dialogue on CCPs' management of and potential losses arising from NDLs.

In terms of other recent work by regulators that is relevant to the discussion around NDLs, we acknowledge the Financial Stability Board ("FSB"), CPMI and IOSCO report which summarized an analysis on CCP financial resources for recovery and resolution published in March 2022 ("FSB-CPMI-IOSCO Report).[3] Importantly, this analysis found that only two of the seven surveyed CCPs had sufficient resources to cover losses resulting from a cyber theft scenario and highlighted the need for continued work on "the sufficiency of the existing toolkit for CCP resolution, focusing in particular on non-default loss scenarios."

As the Discussion Paper acknowledges, CCPs face a wide range of potential NDLs, some of which could result in significant monetary losses. For example, CCPs are responsible for managing substantial amounts of collateral on a daily basis and are consequently vulnerable to cyber-threats and attacks that could lead to significant losses. CCPs could also incur losses resulting from operational failures, fraud, theft or malicious acts of employees or external actors, credit deterioration of investments and custodian or settlement bank failure. Given the systemic role of CCPs within the financial system, it is critical that CCPs have policies, procedures and resources to mitigate and manage such risks.[4]

Given the Discussion Paper's findings regarding the wide range of sophistication in CCPs' practices to address NDLs and certain CCPs' practices being inconsistent with the PFMIs,

[1] CPMI-IOSCO: A Discussion Paper on Central Counterparty Practices to Address Non-Default Losses available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD709.pdf
[2] A Path Forward for CCP Resilience, Recovery and Resolution available at https://www.jpmorgan.com/solutions/cib/markets/a-path-forward-for-ccp-resilience-recovery-and-resolution
[3] FSB: Central Counterparty Financial Resources for Recovery and Resolution available at https://www.fsb.org/2022/03/fsb-cpmi-and-iosco-analysis-highlights-need-to-continue-work-on-ccp-financial-resources/
[4] We acknowledge that there may be specific scenarios related to custodial and settlement bank risk in which CCPs disclaim responsibility for potential losses within their rules. In these instances, we would expect that the enforceability of these rules would remain subject to a standard of care in the CCP managing such risk.

combined with the findings of the FSB-CPMI-IOSCO Report regarding shortfalls in financial resources to cover NDLs at some CCPs, we believe policymakers should develop further standards at a global level on CCP practices to address these and ensure CCPs maintain adequate resources to cover NDLs. We also believe that after providing CCPs with a suitable time for implementation it would be helpful for CPMI-IOSCO to undertake Level 3 monitoring of these standards to ensure CCPs globally have robust frameworks in place.

We highlight the following areas in particular (which were also highlighted in the White Paper) which we believe warrant the development of further standards.

- **Regulators should require CCPs to be responsible for NDLs and maintain appropriate levels of resources to manage them.** It is generally not appropriate for clearing members or end-users to bear NDLs, since they are not responsible for the risk management decisions that could lead to them. Doing so could create moral hazard due to the disconnect between those managing the risk and those that would bear the potential losses. The Discussion Paper notes that some CCPs use rule-based loss allocation mechanisms to address losses arising from a range of potential losses, including general business risk, operation risk and legal risk. We believe regulators should require CCPs to make clear in their rulebooks that they bear responsibility for NDLs.

- **Regulators should require CCPs to manage, monitor and hold sufficient capital against NDLs to ensure such losses do not disrupt a CCP's ability to perform its critical functions within the market.** The Discussion Paper notes that CCPs generally consider their own funds as the primary resource for covering NDLs. However, current regulatory capital requirements, to the extent they exist, are insufficient in this regard as they generally do not result in a meaningful amount of capital held relative to the size of potential NDLs. The FSB-CPMI-IOSCO Report highlights this shortfall in its findings regarding the insufficiency of resources to cover certain NDLs. To address this gap, it is important that each CCP identify, based on its own unique risk profile, the various sources of NDLs that it may be subject to and establish a framework to quantify the NDLs to ensure sufficiency of resources that it should maintain. We believe the global regulatory community should work together to develop a robust capital framework for CCPs that covers both default and non-default losses.

- **Regulators should require CCPs to provide adequate transparency into the potential size of losses that can result from NDL events as well as the level of resources maintained to address them.** We welcome the Discussion Paper's focus on the adequacy of transparency to participants, including the need for participants to "have an accurate understanding of the risks they face from participating in a CCP, including the risks arising from NDLs." We agree that transparency around a CCP's practices to address NDLs is critical, including the NDL-related risks the CCP faces and how resources are sized and structured to address them. Currently, there is limited disclosure, both qualitative and quantitative, provided to market participants on the governance process and timelines to address NDLs, potential size of NDLs and the calibration of CCP capital resources to address this risk. While the Public Quantitative Disclosure (PQD) standards applicable to CCPs require the disclosure of the size of six-months' of operating expenses, the Discussion Paper appropriately recognizes this may not be an accurate indicator of potential losses during wind-down or an indicator of the size of NDLs. We encourage further work to enhance such disclosures and provide greater transparency for market participants.

- **Regulators should require CCPs to conduct periodic crisis management exercises to review and test adequacy of such resources, inclusive of external stakeholders.** As we note in the White Paper, "enhancing governance practices to obtain and address input from a broader array of market participants on relevant risk issues" is a critical component for improving CCP resilience. Such exercises should include a wide range of external stakeholders who can provide valuable insight and inputs into the quantification and impact of NDLs. While the Discussion Paper notes that "almost all" CCPs conduct crisis management drills, it also notes that only "some" include external stakeholders in such drills. We believe that regulators should require CCPs to include market participants in these exercises such that they have the opportunity to provide inputs and feedback based on the findings.

We appreciate the opportunity to provide our input and look forward to ongoing engagement with CPMI-IOSCO and other market stakeholders to strengthen the overall system. If we may provide further information or answer any specific questions, please do not hesitate to contact us.

Sincerely,

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