Clearing Centre MFB

Question 1: What are the considerations for a CCP's board when determining whether and how to assign tasks related to the planning and conduct of default management auctions within the CCP's risk management framework? How does the CCP's board identify potential limits to the assigned responsibilities?

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Questions 2: What different considerations may apply when a CCP's board establishes procedures for consulting external experts, such as independent consultants or clearing members, when designing or conducting a default management auction? How does a CCP's board address such concerns?

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Question 3: Do you agree with the description of a successful auction in the discussion paper? Do you agree with the scenarios identified that would constitute an unsuccessful auction, and are there additional such scenarios?

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Question 4: What are the primary challenges in achieving a successful default auction? In addition to those included in the discussion paper, are there other elements in the design of an auction that a CCP could consider in order to increase the likelihood of a successful auction?

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Question 5: Do you agree with the description of a successful auction in the discussion paper? Do you agree with the scenarios identified that would constitute an unsuccessful auction, and are there additional such scenarios?

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Question 6: Do you agree with the description of a successful auction in the discussion paper? Do you agree with the scenarios identified that would constitute an unsuccessful auction, and are there additional such scenarios?

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Question 7: In addition to those outlined in the discussion paper, are there other considerations that may be useful for a CCP to take into account when designing its hedging strategy, including circumstances where a CCP may wish to delay hedging?

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Question 8: How do you incorporate cross-margining arrangement considerations in the hedging strategy and in the broader auction design process?

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Question 9: The discussion paper notes that, with respect to hedging, execution methods vary and depend on a CCP's choice of hedging instruments. What methods are used for hedging, and what is the rationale for implementing (or not implementing) a particular method?

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Question 10: What factors, other than those identified in the discussion paper, do you see as relevant when determining how to split a portfolio? Are there situations where certain factors would be more important than others? Please provide examples.

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Question 11: The discussion paper describes two common auction formats. Are there other auction formats not included that could be beneficial for a CCP to consider employing? What factors influence the decision to implement (or not implement) a particular auction format?

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Question 11. A: Besides promoting competitive bidding, are there other considerations for choosing two-way pricing? Are there circumstances where it would be beneficial or circumstances where it might not be appropriate? If so, please describe.

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Question 11.B: What are the considerations for choosing to use a reserve price in an auction? Are there circumstances where it would be beneficial or circumstances where it might not be appropriate? If so, please describe.

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Question 12: The discussion paper highlights two factors that affect the amount of time auction participants may need to evaluate a portfolio and submit bids. Are there other factors that are important to consider? Is there a minimum time period that a CCP should consider providing to auction participants?

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Question 13: If a clearing member contributes a "significant" part of the default fund, should that clearing member automatically be included in the auction process? What reasons are there for not including the clearing member?

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Question 14: The discussion paper discusses the trade-off between flexibility and predictability. How do you assess these trade-offs? Can you elaborate on the ways you provide for predictability while still maintaining flexibility (eg establishing rules and conditions to govern the determination of auction parameters)?

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Question 15: If a CCP uses juniorisation as an incentive to encourage competitive bidding, and in a scenario where the CCP has invited only a subset of participants to an auction, how will the CCP apply the juniorisation to the clearing participants who were not invited?

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Question 16: CCPs may distribute information that would help auction participants estimate the potential impact of a successful auction bid on their margin requirements. Besides those that members and clients would having during BAU, what information (and at what level of detail) or tools would be most useful for calculating these estimations and why?

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Question 17: The sharing of confidential information (ie the defaulted participant's portfolio) carries potential risks, as discussed in the paper. What are the potential risks associated with information leakages, how does the CCP balance such risks with other objectives (eg sharing sufficient information for a successful auction), and what are the measures the CCP uses to address such risks?

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Question 18: CCPs use various modes of information transmission during a default management auction (eg email, web-based portal). Can you elaborate on which modes are the most effective in which circumstances and whether it varies depending on the type of information, and why? Would you consider web-based portals a best practice? If so, why?

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Question 19: What are the challenges and trade-offs of creating a realistic default management testing exercise? What processes are used to create the scenarios used in such exercises?

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Question 20: There may be benefits in pursuing greater standardisation and harmonisation across CCPs in relation to certain operational elements which support execution of an auction.

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Question 20.A: For example, should auction portfolio files be in a standard (or partially standardised) format (for different product types)? If so, which aspects of the portfolio file would benefit the most from cross-CCP standardisation (eg file type, layout, order of information or content)?

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Question 20.B: Besides CCP portfolio files, which other operational elements would benefit (the most) from greater standardisation and harmonisation across CCPs?

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Question 20.C: Are there specific operational elements or areas where standardisation and harmonisation may not be helpful?

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Question 21: For which markets, asset or product classes and client types would client participation be most feasible and/or desirable? What would be the incentives for clients to participate in auctions? Does this differ for direct vs indirect client participation? Please elaborate in your response.

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Question 22: The discussion paper describes some ways to address the risks borne by a clearing member arising from its clients bidding in an auction. Are there additional ways to address the risks? Are there incentives that a CCP could employ to encourage client participation in an auction (eg ways to encourage clearing members to facilitate their clients' participation)?

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Question 22.A: One option for addressing a disparity in incentives between clearing members and clients is to require clients to contribute an established amount to the default fund prior to participating in an auction. What are the implications of this requirement (such as regulatory, economic or contractual implications) and how can a CCP address these implications?

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Question 23: The discussion paper suggests that the conduct of multi-CCP default management exercises may provide useful insights into the hedging and auction procedures, should these be conducted by multiple CCPs concurrently. Can you elaborate on what specific insights could be obtained in relation to hedging and auctions via these multi-CCP default management exercises, if possible with concrete examples?

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Question 24: Feedback from the industry suggests that introducing a cap on the number of traders that can be seconded to multiple CCPs from a particular common clearing participant at any one time may mitigate the potential burden on clearing participants' participation in DMGs. How could such caps be instituted and implemented in practice? What could be the challenges of introducing such caps? Apart from caps, are there other options a CCP could consider to mitigate this potential burden?

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Question 25: Are there efficiencies or benefits to be gained from CCPs coordinating their respective default management auctions? If so, how?

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Question 25.A. Are there any arrangements that could be coordinated ex ante (eg cross-CCP netting arrangements)? How could these arrangements be established? What would be the challenges with these arrangements? How could these challenges be mitigated?

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Question 26: Are there any additional points of consideration that would contribute to a successful auction that are not mentioned in this discussion paper? If so, what are they?

Executive summary

Committee on Payments and Market Infrastructures and Board of the International Organization of Securities Commissions published a discussion paper on central counterparty default management auctions in order to foster dialogue on the key concepts, processes and operational aspects used by central counterparties (CCPs) in planning and executing default management auctions. This paper presents professional views on default management auctions, particularly, the practicability of auction, auction groups, portfolio splitting, hedging strategies, auction participation and timing consideration.

Practicability

This discussion paper can become a fundamental basis for the development of such a serious subject as default management auctions. Nowadays default management auctions do not have popularity in Russia. Russian financial market is characterized by a narrow selection of instruments in comparison to American and European markets. Consequently, range of strategies in participants' portfolios is also unsophisticated so it is easier to manage/realize linear financial instruments without holding auctions.

Auction groups

We agree that taking quick decisions plays a crucial role in the necessity of holding an auction. We also agree that having a quick response team is a milestone in such a sensitive case: hence the main criterion for choosing between the internal and external groups is the speed of decision-making. Nevertheless decision CCP will bring into force, the last word in the necessity of holding the auction belongs to Chief Risk Officer despite the fact that internal or external groups were chosen.

Split

One of the tools to increase the likelihood of a successful auction is splitting a portfolio. From our point of view correlation of instruments outweighs factors identified in the discussion paper. This criterion may increase the attractiveness of the auction as participants get a well-formed portfolio with a clear strategy. Correlation of instruments is more important to form a portfolio while having instruments that at first glance can't stand at one portfolio and the correlation between then are not obvious, for example, in the case of cross hedging when the underlying commodity is similar but not identical to the commodity or security being hedged. In this case the task of CCPs is to identify correlation between alternative futures price and the price of basis.

Hedging

Designing hedging strategy raises questions about trade-offs between flexibility and predictability. For the most part there are not standard portfolios as well as hedging strategies. Key aim of hedging is to reduce fluctuation immediately. A preference for strategies or instruments depends on the type of hedged risk and the goals of the CCP. For example, option strategies can be divided into groups depending on market expectations such as bull strategies, bear strategies, etc.

Auction participant

Auction procedures also include choosing of participants. At this stage CCPs should develop certain criteria when determining whom to invite to an auction. From our perspective experience of participants is of primary importance. Firstly, risk models of experienced participants consider regulatory requirements and capacity to price the portfolio. Secondly, experience with financial instruments means that business models of participants have already adapted to current situation.

Another question is permission to participate in the auction for clients of the clearing members. Clients' participation in the Russian Federation is not possible because CCPs are not able to communicate directly under current legislation so CCPs can not measure clients' positions. Moreover, there is obviously a conflict of interests between the clearing member and its clients. As it can be solved within the standard approach to conflict of interest management used by brokers, no needs to double the risk during the auction by inviting the member's client to participate.

Time

Timing prior to submitting an auction can influence the result of auction. Expertise shows that time depends on the level of the portfolio complexity. Sometimes 15 minutes may be sufficient for shares and bonds while analysing futures and options require approximately 30 minutes. Additionally, time for pricing of complicated portfolios may be up to 1 hour.

Question 27: What are the potential areas in the context of default management auctions where additional guidance might be most welcome?

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Any other comments/feedback on areas not mentioned above:
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