CME Group

October 4, 2022

VIA ELECTRONIC SUBMISSION

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

To Whom It May Concern:

CME Group Inc. ("CME Group")[1] appreciates the opportunity to comment on the Committee on Payments and Market Infrastructures' ("CPMI") and Board of the International Organization of Securities Commissions' ("IOSCO") *A discussion paper on central counterparty practices to address non-default losses* (the "Discussion Paper").[2]

Chicago Mercantile Exchange Inc. ("CME") is a wholly-owned subsidiary of CME Group. CME is registered with the Commodity Futures Trading Commission ("CFTC") as a derivatives clearing organization ("DCO") ("CME Clearing" or "the Clearing House"). CME Clearing offers clearing and settlement services for listed futures and options on futures contracts, including those listed on CME Group's CFTC-registered designated contract markets ("DCMs"), and cleared swaps derivatives transactions, including interest rate swaps ("IRS") products. These DCMs are CME, Board of Trade of the City of Chicago, Inc. ("CBOT"), New York Mercantile Exchange, Inc. ("NYMEX"), and the Commodity Exchange, Inc. ("COMEX") (collectively, the "CME Group Exchanges"). On July 18, 2012, the Financial Stability Oversight Council designated CME as a systemically important financial market utility ("SIFMU") under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). As a SIFMU, CME is also a systemically important DCO ("SIDCO").

CME Group appreciates CPMI-IOSCO's ongoing focus on supporting the stability of the broader financial system. To that end, CME Clearing responded to CPMI-IOSCO's questionnaire on non-default losses ("NDLs") (the "NDL Questionnaire") and participated in the Financial Stability Board's scenario analysis of central counterparties' ("CCPs") financial resources and tools for recovery and resolution that included two highly severe NDL scenarios (the "NDL Scenario Analysis"). The responses to the Questionnaire are summarized in this Discussion Paper and results of the NDL Scenario Analysis are

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[1] As a leading and diverse derivatives marketplace, CME Group enables clients to trade in futures, cash and over-the-counter markets, optimize portfolios, and analyze data – empowering market participants worldwide to efficiently manage risk and capture opportunities. CME Group's exchanges offer the widest range of global benchmark products across all major asset classes based on interest rates, equity indexes, foreign exchange, energy, agricultural products, and metals. CME Group offers futures trading through the CME Globex platform, fixed income trading via BrokerTec, foreign exchange trading on the EBS platform. In addition, it operates one of the world's leading central counterparty clearing providers, CME Clearing.

[2] Committee on Payments and Market Infrastructures and Board of the International Organization of Securities Commissions, *A discussion paper on central counterparty practices to address non-default losses* [hereafter, "Discussion Paper"] (Aug. 2022), *available at* https://www.iosco.org/library/pubdocs/pdf/IOSCOPD709.pdf.

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summarized in FSB-CPMI-IOSCO's report on *Central Counterparty Financial Resources for Recovery and Resolution* ("the Report").[3] Since CME Clearing participated in the NDL Questionnaire, its practices as it relates to the questions for comment in Discussion Paper have already been represented to CPMI-IOSCO and thus, CME Group provides some overarching views on the Discussion Paper in this letter.

The NDL Questionnaire and NDL Scenario Analysis provide significant evidence of the comprehensive nature of CCPs' practices for addressing NDLs, including from both a qualitative and quantitative perspective. For example, despite the extreme and implausible nature of the NDL Scenario Analysis, which CME Group describes in detail in its comments on the Report, the participating CCPs were largely able to successfully navigate the scenarios.[4] As another example, the limited historical data for severe NDL events, as noted in the Discussion Paper, demonstrates the effectiveness of CCPs' practices in addressing NDLs, since they have not occurred in the first place.[5] The outcomes of the NDL Questionnaire and NDL Scenario Analysis coupled with jurisdictions' local implementations of CPMI-IOSCO's *Principles for financial market infrastructures* ("PFMIs")[6] gives us confidence in the NDL practices developed by CME Clearing and other CCPs.

More specifically, the PFMIs set out a number of practices for CCPs' management of NDL-related risks, including in Principles 1, 3, 15, 16, and 17. In line with Principle 3 of the PFMIs that states that CCPs "should have risk-management policies, procedures, and systems that enable it to identify, measure, monitor, and manage the range of risks that arise in or are borne by the"[7] CCP, the Discussion Paper finds that "[g]enerally, CCPs consider a range of NDL scenarios that may arise from risks relevant to their business activities, including general business risk, operational risk, investment risk, custody risk and legal risk."[8] The PFMIs rightfully allow local jurisdictions to appropriately tailor legislative and regulatory requirements to their local legal and regulatory frameworks and the CCPs they oversee. This has proven to be a successful approach, as evidenced by the NDL Questionnaire and NDL Scenario Analysis. The Discussion Paper recognizes the value of a principles-based approach in highlighting that effective approaches to addressing NDLs include tailoring practices to a given CCP's unique characteristics and risk profile.[9] The PFMIs, including with respect to NDL-related risks, have clearly benefited CCPs and their local markets. Therefore, as described further below, we are concerned that a move towards more prescriptive standards or guidance for CCPs' management of NDL-related risks could undermine, rather than supplement, the accomplishments of policy-makers and CCPs to date. As such, we greatly appreciate the Discussion Paper's statement that it "is not intended to create additional standards for CCPs beyond those set out in the PFMI."[10]

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[3] Financial Stability Board, Committee on Payments and Market Infrastructures, and Board of the International Organization of Securities Commissions, *Central Counterparty Financial Resources for Recovery and Resolution* [hereafter, "Report"] (Mar. 2022), *available at* https://www.fsb.org/wp-content/uploads/P090322.pdf.

[4] Letter from CME Group to FSB-CPMI-IOSCO re the Report, dated Apr. 29, 2022, *available at* https://www.fsb.org/wp-content/uploads/CMEGroup.pdf.

[5] *Discussion Paper* at pg. 8.

[6] Committee on Payment and Settlement Systems (later renamed the Committee on Payments and Market Infrastructures) and Board of the International Organization of Securities Commissions, *Principles for financial market infrastructures* [hereafter, "PFMI"] (Apr. 2012).

[7] *PFMI* at Principle 3, Key Consideration 1.

[8] *Discussion Paper* at pg. 7.

[9] *See Discussion Paper* at pgs. 7, 8, and 15.

[10] *Discussion Paper* at pg. 6.

One of the most notable takeaways from the Discussion Paper is the diversity of practices that CCPs employ for addressing NDLs, as well as the Discussion Paper's recognition that the assumptions and scenarios CCPs use to quantify potential NDLs are commonly informed by expert judgement given the challenges of modelling losses that are low probability, high-impact events with limited historical data. The diversity of these practices and use of expert judgement should be embraced to the extent that they are consistent with a given jurisdiction's local implementation of the PFMIs, as they allow a CCP to effectively manage the unique risks it faces. We are concerned that the diversity of these practices and use of expert judgement would be negatively impacted by granularly defining standards and guidance, which ultimately, would undermine the effectiveness of CCPs' practices for managing NDLs. Even more troubling, this could lead to a CCP failing to account for an NDL-related risk that is unique to it, due to the prescriptive nature of any adopted standards and/or guidance.

It is well recognized by the industry, including in this Discussion Paper as noted above, that CCPs have unique risk profiles and face different risks than banks and other financial entities. Further, CCPs clear a variety of different products with their own individual risk factors, and more broadly, have different operating structures. This is evidenced by the diversity of impacts of clearing member default scenarios included in the CFTC's supervisory stress tests conducted in 2016.[11] For NDL-related risks, the diversity of impacts increased exponentially by virtue of the variety of fact patterns that exist for NDLs, including, but not limited to, custody risk, settlement bank risk, investment risk, operational risk, legal risk, and general business risk. The permutations that exist for the NDL scenarios are exponentially greater than those that exist for clearing member default losses, not only because of the various risks that can lead to NDLs but also the varying practices CCPs employ for managing these risks. This makes it impossible for any policy-maker to be able to identify all the unique NDL-related risks for which a CCP is subject and even more challenging for a policy-maker to dictate that way in which such risks should be managed. This again demonstrates the value of the PFMIs, in particular for NDL-related risks, and therefore, prescriptive standards or guidance should not be adopted by CPMI-IOSCO.

In addition, we recognize that the Discussion Paper notes that "there is limited common understanding of CCPs' current practices to address NDLs" as compared to default losses, but we believe this is a mischaracterization of the circumstances.[12] Default losses are inherently more straightforward to understand because they are generally managed in a consistent manner across CCPs, whereas CCPs employ appropriately diverse practices to address NDLs, as described above. Importantly, CCPs also provide significant public disclosure on their risk management practices, including relating to NDL-related risks. First and foremost, CCPs' rulebooks are publicly available and changes to practices are also captured in publicly available rule filings and advisories. Furthermore, CCPs also provide public disclosure via their qualitative and quantitative PFMI disclosures.[13] Helpfully, CCPs' PFMI disclosures

[11] Commodity Futures Trading Commission, Supervisory Stress Tests of Clearinghouses (Nov. 2016), pg. 2, *available at* https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/cftcstresstest111516.pdf.

[12] *Discussion Paper* at pg. 4.

[13] *See* CME Clearing's qualitative and quantitative PFMI disclosures, available here: https://www.cmegroup.com/clearing/risk-management/files/cme-clearing-principles-for-financial-market-infrastructures-disclosure.pdf and https://www.cmegroup.com/clearing/cpmi-iosco-reporting.html, respectively.

are also made in a standardized format,[14] which allows stakeholders to efficiently intake this information. To further support this standardization, CCP12[15] has adopted a disclosure template and FAQ guide for CCPs' quantitative disclosures.[16] In addition, CCPs also provide transparency to market participants through risk committees, working groups, coordination through industry associations, and 1-on-1 discussions. Transparency into CCPs' NDL practices is also inherently provided by the Discussion Paper that summarizes the responses of the NDL Questionnaire, which included responses from over 20 CCPs in 10 different jurisdictions.[17]

In conclusion, CME Group thanks CPMI-IOSCO for the opportunity to provide feedback on the Discussion Paper and is hopeful that its responses to the NDL Questionnaire and participation in the NDL Scenario Analysis have proved valuable as policy-makers evaluate CCPs' practices for addressing NDLs. We are confident that the work of CPMI-IOSCO, as well as the FSB, has demonstrated the robust approach CCPs have taken to managing NDL-related risks, consistent with local implementations of the PFMIs. We are concerned that any further prescription in this area could have detrimental effects on CCPs' risk management practices and encourage CPMI-IOSCO to avoid such an outcome. We would be happy to further discuss our comments with CPMI-IOSCO. If any comments or questions regarding this submission arise, please feel free to contact me at suzanne.sprague@cmegroup.com or Sean Downey at sean.downey@cmegroup.com.

Sincerely,

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[14] Committee on Payment and Settlement Systems (later renamed the Committee on Payments and Market Infrastructures) and Board of the International Organization of Securities Commissions, *Principles for financial market infrastructures: Disclosure framework and Assessment methodology* (Dec. 2012) and Committee on Payments and Market Infrastructures and Board of the International Organization of Securities Commissions, *Public quantitative disclosure standards for central counterparties* (Feb. 2015).

[15] CCP12 is a global association for CCPs, representing 40 members who operate more than 60 individual CCPs globally across the globe, *see* also https://ccp12.org/.

[16] *See* CCP12 quantitative disclosures resources, *available here* https://ccp12.org/pqd/.

[17] *Discussion Paper* at pg. 5.