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VIA E-MAIL TRANSMISSION

The Committee on Payments and Market Infrastructures (CPMI) Secretariat
(cpmi@bis.org)
The International Organization of Securities Commissions (IOSCO) Secretariat
(consultation-05-2022@iosco.org)

Re: CPMI-IOSCO discussion paper on CCP practices to address non-default losses

Ladies and Gentlemen:

The Depository Trust & Clearing Corporation ("DTCC"), together with its registered central counterparty subsidiaries, Fixed Income Clearing Corporation ("FICC"), and National Securities Clearing Corporation ("NSCC"), welcome the opportunity to comment on the discussion paper issued in August 2022 by the Committee on Payments and Market Infrastructures (CPMI) and the Board of the International Organization of Securities Commissions ("IOSCO") entitled "A discussion paper on central counterparty practices to address non-default losses" (the "Discussion Paper").[1] DTCC acknowledges the importance of CPMI and IOSCO's efforts on this topic, and appreciates their continued engagement with regulators, central counterparties ("CCPs") and industry groups. Given the critical role CCPs play in financial markets, DTCC acknowledges the importance of facilitating the sharing of best practices by CCPs with respect to managing non-default losses ("NDLs") and fostering dialogue on current practices in this area. Recognizing the Discussion Paper poses a series of questions grouped by topic, rather than offering specific responses to each question, we provide below thematic responses and share several examples of how we have sought to approach the challenge of NDLs both internally and with our participants and other stakeholders.

<u>Background</u>

DTCC's common stock is owned by the financial institutions that are participants of its registered clearing agency subsidiaries: FICC, NSCC, and the Depository Trust Company ("DTC"). NSCC and FICC provide CCP services for multiple asset classes, including U.S. equities, corporate and municipal bonds, and government and mortgage-backed securities. The Government Securities Division of FICC is the leading provider of trade comparison, netting and settlement for the U.S. Government securities marketplace. The other division of FICC is the Mortgage-Backed Securities Division, which provides CCP services for mortgage-backed securities, including To-Be-Announced securities. NSCC provides clearing, settlement, risk management, and CCP services for trades involving equities, corporate and municipal debt, exchange-

[1] See CPMI and IOSCO, Discussion Paper entitled "A discussion paper on central counterparty practices to address non-default losses" (August 2022), available at: https://www.bis.org/cpmi/publ/d208.pdf.

traded funds, and unit investment trusts in the U.S. As a central securities depository, DTC provides settlement services for virtually all equity, corporate and municipal debt trades, and money market instruments in the U.S. Each of these registered clearing agencies has been designated as a systemically important financial market utility ("SIFMU") by the U.S. Financial Stability Oversight Council pursuant to Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

DTCC is owned and governed by the users of its SIFMU subsidiaries, all of whom commit capital as owners, pay fees for services and ultimately benefit from the safeguards, efficiencies, and risk mitigation that DTCC provides. This ownership model effectively aligns interests among users, the board of directors and management, while fostering capital efficiency and delivering cost-effective operating and processing solutions. DTCC's board is currently comprised of directors, a majority of which are representatives of participants in the SIFMU subsidiaries, including international broker-dealers, custodian and clearing banks and investment institutions. Individuals are nominated for election as directors based on their ability to represent DTCC's diverse client base, including direct and indirect users across the global financial services industry. Directors serve on a variety of board committees with responsibility to oversee all aspects of DTCC and its SIFMU operations, including the management of risk. There are also directors who are not affiliated with any participant, but who have backgrounds in financial services and provide independent perspective.

Executive Summary

DTCC appreciates the importance of the Discussion Paper's objectives to advance industry efforts, foster dialogue and increase transparency among participants and stakeholders on the key concepts and processes used by CCPs in developing their plans for addressing NDLs. As discussed further below, DTCC engages in a variety of practices intended to increase participant and stakeholder awareness of the ways in which DTCC manages NDLs, and how such practices can implicate obligations and consequences for all the parties involved. Such obligations and responsibilities can include, for example, ensuring participants understand and prepare for satisfying obligations under our CCP loss allocation rules, as well as making sure stakeholders, like our liquidity providers and clearing banks, understand how their existing relationships with our CCPs will operate if an NDL occurs. We also engage in ongoing dialogue and share best practices with other CCPs, which we consider of the utmost importance in terms of expanding and sharing our knowledge in this area. This type of CCP industry engagement is accomplished through a number of means, including DTCC's representation in industry organizations, such as CCP12 and the World Federation of Exchanges, and participation in industry-wide testing events with other CCPs, our members and market participants (e.g., industry cyber planning).

We believe that the information sharing and feedback practices we describe in this letter are effective in helping our CCPs continue to develop and refine effective approaches to addressing NDLs. In some cases, the examples we highlight below include practices that go beyond the types of examples set forth in the Discussion Paper. While we believe that many CCPs engage in similar practices, our preliminary experience has been that the overall range of practices can vary across the entire diversified universe of CCPs. Therefore, we hope that sharing these examples will help demonstrate to CPMI-IOSCO and interested market participants two important points. First, many CCPs are already committing significant time and resources to ensuring NDL preparedness for both themselves and for the markets they serve. Second, the form and substance of those intensive efforts must practically vary across the scope and scale of different cleared markets serviced by CCPs.

In light of these points, we do not believe it is possible, let alone immediately necessary, to seek a prescriptive policy approach that standardizes CCP management of NDLs. At the same time, we think that the Discussion Paper raises important points that need ongoing attention and focus. We further believe that the Discussion Paper provides a useful foundation for CPMI-IOSCO to use to encourage more structured dialogue and information-sharing among CCPs, participants and stakeholders along the lines of what we continue to do for our CCPs in approaching NDL issues today. Such encouragement could take the practical form of CPMI-IOSCO establishing workshops and other standardized communication channels that bring those constituencies together in a structured, focused format. This initiative could be similar to what was done by CPMI-IOSCO in the default management space, where CPMI-IOSCO first published a discussion paper and then issued a final report with specified areas of further focus and inquiry, and a request to the CCPs and the broader industry to achieve collaborative progress on those areas and report back with progress to CPMI-IOSCO by an established deadline.[2] We believe such industry engagement, in conjunction with the existing standards set out in the Principles for Financial Market Infrastructures (PFMIs),[3] provide the necessary guidance and an effective framework from which CCPs can develop and adapt as needed, for use based on their unique business models, their risk management practices in this area.

Discussion

A. Representative Examples

Recognizing the Discussion Paper solicits comment on notable practices covering NDLs that could promote operational effectiveness,[4] and provide effective governance, transparency and engagement with participants and authorities,[5] DTCC offers the following representative examples that we believe are responsive to the questions posed. We believe these are examples of practices that could be used and adapted by other CCPs regardless of their size and/or facilitated and expanded through industry tabletop exercises and workshops.

Case Study No. 1: Amendments to Member Loss Allocation Requirements

We believe that the following example demonstrates effective practices that, based on our internal observations and member input, have served to increase the operational effectiveness of the CCPs' loss allocation preparedness and provided transparency and increased awareness among DTCC's membership.

[2] See Cover Note to the CPMI-IOSCO report on Central counterparty default management auctions – Issues for consideration", available at: https://www.bis.org/cpmi/publ/d192_covernote.pdf and https://www.iosco.org/library/pubdocs/pdf/IOSCOPD657-cover-note.pdf. The report itself can be found at: https://www.bis.org/cpmi/publ/d192.pdf and https://www.iosco.org/library/pubdocs/pdf/IOSCOPD657.pdf.

[3] Committee on Payment and Settlement Systems and International Organization of Securities Commissions, Principles for financial market infrastructures, April 2012.

[4] See Discussion Paper, Section 3, Question No. 16.

[5] See Discussion Paper, Section 5, Question No. 24.

In 2018, each of the DTCC clearing agencies (DTC, NSCC and FICC) made enhancements to their rulebooks covering the member loss allocation process (the "Loss Allocation Rules"). The changes were intended to align the loss allocation procedures across the DTCC clearing agencies and, among other things, clarified members' loss allocation obligations for NDL events; specified the timeframe in which the CCP would require funds to satisfy loss allocation obligations; and set forth the associated governance. For purposes of providing advance notice to members about these changes, we conducted a series of outreach efforts to all members, including members that are G-SIBs, broker-dealers, banks, and central securities depositories. This outreach took various forms, such as industry working group presentations and bilateral meetings with members and settlement banks. Thereafter, and subsequent to the updates to the rules becoming effective, we continued to perform member outreach as well as engage external industry stakeholders to provide transparency as to how the rules were changing and how members would be impacted so they can be prepared in the event loss allocation was ever invoked. All of these efforts were in addition to responding to comments submitted by participants and stakeholders to our proposed rule changes and discussing with our regulators.

Further, to ensure members' understanding of how DTCC's default and non-default loss allocation practices work, DTCC developed a series of on-demand training webinars for each clearing agency that are accessible on the Members-only portion of DTCC's website. The webinars provide an overview of, among other things (i) the required operational actions of Members; and (ii) the actions that would be taken by the clearing agencies in the event loss allocation is required. Importantly, the webinars include an example of how the clearing agencies calculate a member's' loss allocation exposure amounts. The on-demand training webinars are reviewed annually and republished if process changes are made by DTCC, or edits made based on Members' feedback or questions. In addition to the on-demand training webinars, DTCC hosted a live webinar for members and some external stakeholders which provide them with the opportunity to ask questions in real-time during the presentation. Some examples of the types of questions we received during the Q&A session of the webinar included whether NDLs are treated differently during the loss allocation process (which they are not) and what will happen to remaining losses if all members elect to withdraw from the clearing agency due to loss allocation.

A methodology change to each clearing agency's contribution to loss allocation, referred to as the "Corporate Contribution," was one of the changes made to the Loss Allocation Rules. One of the reasons for this change was to provide more clarity in the rules about the amount and how the clearing agency would apply its own corporate funds towards an NDL. Prior to adoption of the Loss Allocation Rules, in order to obtain Member input on this particular aspect of the rule proposal, the proposed changes were reviewed by DTCC's Risk Advisory Council ("RAC"), which is comprised of external senior risk management experts from DTCC's participant-shareholders and other parties interested in the financial markets. We have found this type of engagement in the rule-change process is an effective way to provide transparency and help members gain an understanding of the rules being reviewed.

In addition to what we have described above regarding engagement of DTCC's RAC, in response to the question posed in Section 5 of Discussion Paper on effective practices regarding member and third-party engagement,[6] DTCC has other advisory committees and groups comprised of participant representatives who are not board members, but provide industry perspectives from their employer-organizations. Such

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[6] See Discussion Paper, Section 5, Question Nos. 24 and 25.

groups include our Clearing Agency Liquidity Council, Client Risk Forum, FMI Forum, and our Systemic Risk Roundtable. DTCC has utilized these groups for obtaining both internal and external stakeholder feedback. Based on our experience, many CCPs use a combination of one or more of these approaches to obtain stakeholder feedback. As we noted earlier herein, these types of engagement efforts and information sharing of best practices are where we believe the focus should be in this area.

Case Study No. 2: Member Due Diligence Sessions on Recovery & Wind-down planning

Consistent with the Discussion Paper's focus on CCPs' management of potential losses from NDLs, in particular in the context of recovery and orderly wind-down,[7] the following case study provides an overview of the annual client due diligence session that DTCC conducts with members on this topic. We received feedback from members who noted the session has helped to inform their preparedness, in the unlikely event of a wind-down of one of the DTCC clearing agencies and requested that the session be conducted on an annual basis. We also hold bilateral meetings with members and their representatives, such as with their outside counsel, to help inform their resolution planning and respond to questions they may have regarding the CCPs' rules on this subject.

Beginning in 2022, the clearing agencies hosted an annual live webinar due diligence session with the goal of providing all members, including G-SIB members and smaller member firms, with insights into DTCC's recovery and wind-down planning from the perspective of a member failure and a clearing agency failure. As set out in the presentation deck, the webinar covered subjects that based on member inquiries, are those that our members are focused on, which included how the CCPs would address NDLs. Attendees, who were primarily representatives from members' risk groups and recovery and resolution teams, were presented with a walk-through of the expected actions the clearing agencies would take in the event members were experiencing severe stress or were themselves in resolution. Conversely, members were presented with a description of the key elements included in the clearing agencies recovery and wind-down plans, such as the process that would be undertaken in a recovery situation. The presentation deck displayed a diagram of the loss allocation waterfall based on the CCPs' rules, which specifically identified the elements that are applicable to an NDL event. The webinar featured a panel of subject matter experts from DTCC's risk group, recovery and resolution team, legal and finance departments.

B. Identification of NDL Scenarios and Quantification of NDLs

In terms of the questions posed in the Discussion Paper on the use of a scenarios-based approach to NDLs,[8] we believe the effectiveness of this approach differs depending on the purposes for utilizing it. For this reason, we believe that CCPs should be given the discretion to select a methodology that fits their objectives and business models. For example, we think that scenarios are useful when designed to help the CCP identify risks and educate its members on the circumstances that could arise which could lead the CCP to call for additional financial resources, such as through loss allocation. They are also an effective means for CCPs to conduct internal testing and simulation exercises with external parties, as we do with liquidity providers and clearing banks. Scenarios can also be helpful in support of established capital quantification

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[7] See Discussion Paper, Executive Summary and Section 2, Question No. 14.

[8] See Discussion Paper, Section 2, Question Nos. 5 and 7.

methodologies, such as the BIS framework. Among other approaches, the CCPs use the guidance from the BIS to apply and adapt such methodologies to quantify the amount of capital to be set aside to cover a given risk. For example, we hold cross-functional discussions to understand how risks could materialize and could lead to capital depletion for DTCC and its CCPs, and then assess whether the quantitative methodology sufficiently covers such outcomes.

Additionally, DTCC has processes to enable DTCC to identify and consider future scenarios that may materially impact the CCPs' business to an extent that threatens everyday viability of the business/organization. This framework allows the organization to identify possible vulnerabilities in critical functions and critical external dependencies, such as the use of critical third-party vendors, across the enterprise and understand more fully the risks and the potential impact of stressful events and circumstances on the financial condition of the CCPs.

C. Third-Party Due Diligence Efforts

Regarding the questions posed in the Discussion Paper on CCPs' practices with respect to managing the risk of third-party vendors and their preparedness for addressing NDLs,[9] the DTCC CCPs, like many other FMIs, have robust risk management processes to identify its critical third-party vendors and conduct oversight and engagement with respect to these relationships. For example, in the context of cybersecurity risk, DTCC assesses the cybersecurity risks of its critical third parties by confirming that they have a comprehensive cybersecurity risk management program in place to manage such risks. This includes through the use of contractual obligations requiring critical third-party vendors to maintain controls to manage their technology risks, processes to inform DTCC of incidents that impact the delivery of its products or services, and the ability for DTCC to perform due diligence on the third-party with regard to these controls and preparedness. The due diligence process also allows DTCC to periodically engage the third-party provider to respond to questions or submit evidence (e.g., SOC1) that provides reasonable assurance that the third-party is continuing to execute on its cyber risk management program.

Conclusion

As described herein, DTCC believes that our existing practices in addressing NDLs, which promote transparency, preparedness, and an understanding of what kind of NDL scenarios might be at issue, are appropriate and effective. Moreover, we are also thinking of ways in which we can enhance our practices and do even more in this area, such as expanding engagement of critical third- parties. We support efforts to increase the dialogue and information sharing and encourage CPMI-IOSCO to bring together industry participants to share practices through organizing workshops or tabletop exercises. As has been the case with respect to default management, these types of efforts have proven to be successful in informing stakeholders and improving practices in the markets overall.

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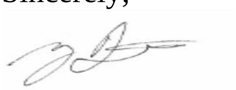
[9] See Discussion Paper, Section 3, Question Nos.17 and 18.

We appreciate this opportunity to respond to the issues raised in the Discussion Paper and your consideration of the views expressed in this letter. We welcome the opportunity to discuss the Discussion Paper and our comments. If you have any questions or need further information, please contact me at mpozmanter@dtcc.com.

Sincerely,



Murray Pozmanter