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Submitted by email to cpmi@bis.org and consultation-06-2021@iosco.org

7 February 2022

Dear sir/madam,

**RE: Discussion Paper on Client Clearing: Access and Portability**

The Investment Company Institute (ICI), including ICI Global,[1] welcomes the opportunity to provide input to CPMI-IOSCO's work on access models for client clearing and on portability practices. ICI members – regulated funds in jurisdictions around the world – use centrally cleared derivative contracts in a variety of ways to achieve their investment objectives in accordance with the terms of each fund's prospectus.

We support CPMI-IOSCO's efforts to enhance common understanding of new access models and effective porting practices, with a view to identifying potential issues for follow-up work from the industry at international level. We have long argued that central clearing should be supported by a coherent and consistent international framework. This is of particular importance because of the cross-border nature of the derivatives markets and the inherent complexities of clearing requirements across multiple jurisdictions.

Our observations on the client clearing access and portability issues raised in the discussion paper are summarised below and set out in more detail in the remainder of this letter:

- **Sponsored access** – a small but growing portion of funds use sponsored access, particularly for repo clearing. However, potential financial benefits for funds are offset by heightened costs and challenges such as limitations on access, additional infrastructure requirements, contingent guarantees, additional legal and operational complexity, captive execution, and investor protection risks. Furthermore, funds often lack clarity over the role of sponsors vs sponsored members in times of stress (e.g., immediate obligations to meet intra-day margin requirements.) We support ongoing work to address the challenges and enhance the benefits of sponsored access both in relation to cleared swaps and repos. We also see value in enhancing the transparency of central counterparty (CCP) approaches to provide greater certainty and clarity to clients and to improve market confidence.

- **Direct access** – as CPMI-IOSCO recognise, legal, regulatory, and operational issues typically prevent funds from accessing clearing services directly. We broadly support the

[1] ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of $42.7 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Brussels, Hong Kong, and Washington, DC.

development of alternative access models that reduce the costs, volatility and risks associated with central clearing. We also welcome work to explore whether the challenges associated with direct access for funds can be resolved in a manner that provides net benefits for funds compared to traditional client clearing service provider (CCSP) access models.

- **Porting** – the efficient and timely porting of client positions in the event of a CCSP's default provides a multitude of benefits to clients such as funds and to the wider market. CPMI-IOSCO should encourage global efforts to enhance effective porting and address issues that limit the ability to port. Funds currently are not always able to secure the services of a backup CCSP. Even when they have a backup CCSP in place, funds may be ported to another CCSP (e.g., if a default CCSP's positions are ported on a wholesale basis) and may face hurdles in understanding, in relatively short order, the operations of the new CCSP (e.g., approach to margining, credit requirements etc.) While successfully porting positions to the new CCSP may be preferable for funds compared to a forced liquidation, the new CCSP may not meet the fund's eligibility criteria or regulatory requirements. If a fund is ported to an unsuitable CCSP, it may be necessary for it to undertake a further porting exercise to move positions to a more suitable CCSP. To improve common understanding of the different approaches to porting that are adopted by CCSPs and CCPs, we recommend: enhancements to "pre-default" and "at-default" transparency; the development of harmonised protocols; and the use of "dry runs" which simulate hypothetical default scenarios.

## Clearing Access

ICI members that trade derivatives typically access the services of a CCP through a CCSP.[2] A relatively small but growing portion of ICI members, particularly those trading repo, access clearing services through a sponsor (i.e., sponsored access.) We have not identified any ICI members that access clearing services directly. We support the development of alternatives to traditional CCSP access models. As set out below, resolving financial and operational challenges for the use of alternative access models by funds has the potential to benefit funds and their investors, as well as the wider clearing market.

*Sponsored Access*

ICI members appear to make the greatest use of sponsored access models for the clearing of repos in the U.S. market. A relatively small number of ICI members appear to use sponsored access outside the U.S. and for the clearing of non-repo contracts. ICI members report that sponsors in non-U.S. markets typically only provide services for a narrow range of contracts and in some cases only repos.

ICI members that use sponsored access models in the U.S. – particularly for clearing money market investments – cite various potential benefits from sponsored access, including reduced margin commitments through netting, enhanced liquidity, and more competitive pricing. However, ICI members do not universally report that these benefits outweigh the costs and the operational challenges associated with sponsored access models. ICI members cite the following considerations for sponsored access models:

- **Limited access**: Credit requirements of CCPs (particularly outside the U.S.) can present challenges for funds in securing sponsored access – reducing funds' choice of sponsors and/or CCPs. Furthermore, in a sponsored access model, funds risk higher margin requirements or forced liquidations if their net asset value falls below minimum thresholds.

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[2] CCSPs are referred to by various terms in different jurisdictions including futures commission merchants (FCMs), central counterparty (CCP) members etc.

- **Additional infrastructure requirements:** Funds incur operational costs and face additional complexity from building the infrastructure required to support sponsored access. For instance, in a sponsored access model funds need to onboard client accounts and undertake ongoing monitoring of credit limits and management of margin – activities typically undertaken by a CCSP in a traditional "full service" access model.

- **Contingent guarantees:** Potential "balance sheet" benefits from reduced margin commitments through netting may be offset by requirements for funds to guarantee trades to sponsors and to directly pre-fund margin. As margin is typically pre-funded by a CCSP in a traditional access model, the pre-funding of margin by an investment fund in a sponsored access model imposes an opportunity cost on a fund from keeping available capital for margin that could otherwise be invested to generate additional investment return.

- **Additional legal and operational complexity:** Clearing through the CCP's operational infrastructure can add complexity to the margining process for funds compared to other models (e.g., tri-party repo.) In practice, funds are de facto required to "clear" twice in a sponsored access model – at a "block" (i.e., manager) level and at a fund level. This often requires funds to negotiate two sets of bespoke contractual terms that further increases the complexity of legal documentation and the onboarding processes for funds.

- **Captive execution:** Sponsored access has the potential to provide enhanced liquidity compared to other forms of execution (e.g., tri-party.) However, anecdotal evidence from ICI Global members suggests that because many counterparties are not willing to act as sponsors, liquidity is not often materially enhanced in sponsored access models.

- **Investor protection risks:** The need for fund managers to disclose to the sponsor the allocation of trades across funds and other accounts when a trade is initially placed, presents investor protection concerns (e.g., the potential for front-running by third parties from the disclosure of trades.) In traditional access models, fund managers typically disclose the allocation of trades only once confirmation of the trade is received.

As previously discussed,[3] we strongly support greater transparency of CCP operations – including governance and risk management approaches – in the context of resolution planning as an important input to the overall assessment by market participants of the resilience of a CCP. In a similar vein, we see value in enhancing the transparency of CCP approaches to sponsored access, such as margin practices and the operation of the risk management framework. More clearly describing a CCP's approach to the role of sponsors vs sponsored members in meeting intraday margin calls should provide benefits to funds and other sponsored members. Greater transparency of CCP approaches should provide funds with the ability to better plan for stressed events ahead of time, greater certainty during times of stress, and improved market confidence.

*Direct Access*

As noted above, we have not identified any ICI members that access clearing services directly. In most jurisdictions, regulated funds face significant challenges to become direct clearing participants due to legal or regulatory limitations that prevent them from contributing to mutualised loss sharing arrangements. Account structures that seek to address some of these

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[3] For instance. *See* Letter from Patrice Bergé-Vincent, Managing Director – ICI Global, to Secretariat of the Financial Stability Board, RE: Consultative Document – Guidance on Financial Resources to Support CCP Resolution and the Treatment of CCP Equity in Resolution, dated 29 July 2020, available from https://www.fsb.org/wp-content/uploads/ICI-Global-3.pdf

limitations often reduce operational and financial efficiencies for funds compared to traditional CCSP access models.[4]

We are broadly supportive of the development of alternative access models that reduce the costs, volatility and risks associated with central clearing. We welcome further work to examine whether the financial and operational challenges often associated with the use of direct access by funds or fund managers can be resolved in a manner that provides overall net benefits compared to traditional CCSP access models.

**Porting**

The efficient and timely porting of a client positions in the event of a CCSP's default provides a multitude of benefits to clients and the wider market. The successful porting of funds' positions reduces the impact of a default on portfolio investment and risk exposures. On the other hand, forced liquidation causes operational disruption, imposes unnecessary costs on fund investors, and may exacerbate volatility in a stressed market resulting in further defaults.

In seeking to facilitate the successful porting of positions, ICI members may maintain relationships with a secondary "backup" CCSP. Some members report challenges in identifying CCSPs that are willing to act in a backup capacity – given the costs to the CSSP associated with maintaining inactive accounts (e.g., refreshing KYC checks, confirming credit limits etc.). Furthermore, members highlight the risk of accounts being deactivated by the backup CCSP over time. Funds must therefore reconfirm the operational readiness of backup accounts on an ongoing basis.

ICI members cite the following considerations for a framework to provide efficient and timely porting:

- **Pre-default transparency:** CCPs should facilitate access for funds and other clients to the CCP's porting "game plan". Understanding the default management process ahead of time (i.e., before a default is on the horizon) should provide certainty to funds and should enhance client confidence.

- **At-default transparency:** CCPs and CCSPs should provide clients of the defaulted CCSP with efficient access to contract terms and updates on how the default management process is progressing. Disseminating consistent information to clients of the defaulted CCSP should enhance the efficiency and speed with which porting can be completed.

- **Undertaking "dry runs":** CCPs should undertake porting exercises involving CCSPs, clients and other stakeholders to simulate hypothetical default scenarios and identify and seek to resolve potential challenges to porting, such as legal and regulatory requirements of likely alternative CCSPs.

- **Developing harmonised protocols:** Differences in account structures and approaches to porting (e.g., positions only, positions plus collateral, or pre-funding) can impact the speed and likelihood of successfully porting client accounts. CCPs and CCSPs should develop harmonised protocols to ensure a common understanding of differing approaches, including by service providers such as fund administrators undertaking operational work to support porting.

Account structures can materially impact the speed and likelihood of successfully porting positions. For instance, certain account structures or CCP approaches may require all customers

[4] For instance, in ISOC accounts individual customer positions are registered separately and although assets are maintained in a single pool, margining is undertaken on a gross basis, reducing netting benefits and increasing operational complexity for funds.

of a defaulted CCSP to be ported on a wholesale basis to a new CCSP. This new CCSP may not be the fund's selected backup CSSP. While successfully porting positions may be preferable for a fund compared to a forced liquidation, this may result in the fund being ported to a CCSP that doesn't meet its eligibility criteria or regulatory requirements (e.g., exposure limits). If a fund is ported to an unsuitable CCSP, it may be necessary for it to undertake a further porting exercise to move positions to a more suitable CCSP. This secondary porting exercise increases costs and operational complexity.

We recommend further work to improve common understanding of the different approaches to porting that are adopted by CCSPs and CCPs, including the enhancements to "pre-default" and "at-default" transparency, the development of harmonised protocols, and the use of "dry-runs" outlined above. We also recommend work to identify and remove other impediments to successful porting, including capital requirements on receiving CCSPs.

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If you would like to discuss any matter covered in this letter in further detail, please do not hesitate to contact me at giles.swan@ici.org or on +44 7810 654951.

Yours sincerely

/s/

Giles Swan
Director of Global Funds Policy
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