October 18, 2016

The Committee on Payments and Market Infrastructures
The International Organization and Securities Commission

Via Electronic Submission

RE: CPMI-IOSCO Consultative Report on resilience and recovery of central counterparties: Further guidance on the PFMI

Dear Committee Members:

The Minneapolis Grain Exchange, Inc. ("MGEX"), a U.S. Delaware corporation, would like to express its appreciation to the Committee on Payments and Market Infrastructures and the International Organization and Securities Commission ("CPMI-IOSCO") for the opportunity to comment on its consultative report regarding further guidance on the principles and key considerations in the Principles for Financial Market Infrastructures ("PFMI") regarding risk management and recovery planning for central counterparties (the "Report"). MGEX is a designated contract market and derivatives clearing organization ("DCO"), registered with and subject to the jurisdiction of the United States Commodity Futures Trading Commission. In its operations as an exchange, MGEX offers a regulated and transparent commodity exchange for the trading, clearing, and settlement of futures and options transactions. MGEX's Clearing House is a Subpart C DCO and has been recognized as a third-country central counterparty ("CCP") by the European Securities and Markets Authorities.

MGEX appreciates the importance of ensuring that CCPs are sufficiently resilient to withstand clearing member defaults and other stress events and the necessity of having recovery plans that allow CCPs to allocate credit losses and liquidity shortfalls and replenish resources. In addition, MGEX supports CPMI-IOSCO's goal of providing increased clarity for how CCPs should implement the PFMIs. However, MGEX does have concerns with certain aspects of the guidance in the Report, as further explained below. In order to most efficiently respond to the guidance and the questions posed in the cover note to the Report, MGEX has separated its comments into six sections to correspond with those set forth in the Report.

Governance

MGEX agrees with CPMI-IOSCO that the board of directors should establish and oversee a CCP's risk management framework. We are concerned, however, with the detailed responsibilities placed upon the board in the Report. Specifically, the Report appears to make

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the Board responsible for performing certain types of risk management activities rather than generally overseeing such areas. For example, paragraph 2.2.6 suggests that the board should be involved in a CCP's decision to remove a historical event from its margin assumptions or stress testing scenarios, and paragraph 2.2.7 states that daily and intraday margin coverage analyses and stress testing results should be reported to the board at least monthly. Examining this level of detail would result in the board becoming involved in the day-to-day management of a CCP's operations, which is problematic for a number of reasons. The board's focus should remain on the risk management framework as a whole rather than detailed aspects that are more suitable to be analyzed by individuals selected by the board or management for their expertise in such areas. Moreover, should the board become involved in daily risk activities and decisions, it would lose its ability to challenge management on those same decisions and thus weaken one of its essential functions. MGEX therefore recommends that the language of the Report be revised to better delineate between Board and management functions. In the absence of such changes, MGEX fears the guidance will add more confusion rather than clarity surrounding the role of the board of directors.

In addition, MGEX believes many of the board's risk-related responsibilities described in the Report should be performed by a risk committee, which could then periodically report to the board when necessary at a high level. Although paragraph 2.2.14 alludes to the possible use of a risk committee in providing advice and reporting to the board, there are few other references to committees. It is consequently unclear when a risk committee could fulfill certain responsibilities and which ones CPMI-IOSCO believes must remain with the board of directors. As a result, MGEX suggests the Report more explicitly recognize the potential role of a risk committee in executing oversight responsibilities, as contemplated in section 3.2.14 of the PFMIs.[1]

MGEX would lastly like to address the question posed by CPMI-IOSCO in its cover note to the Report under the governance section: *Is the current level of public disclosure by CCPs appropriate? In particular is there a need for further disclosure related to margin and stress testing methodologies? If so, would the disclosure of the items included in the list…and attached as an Annex be appropriate and sufficient for disclosure and feedback purposes?*

MGEX recognizes the need to disclose certain information publically to enable participants to make informed decisions and maintain public confidence, and in compliance with the Public Quantitative Disclosure Standards for CCPs, MGEX regularly discloses a great deal of information. The large amount of data currently disclosed provides more than adequate transparency regarding MGEX's services, products, and general policies and procedures, and MGEX therefore considers the present level of public disclosure appropriate. We do not believe there is any need for further disclosures related to margin and stress testing methodologies and, in fact, are gravely concerned over the level of detail proposed to be disclosed. Given the extent of disclosures already required and those proposed by the Report, MGEX fears that the public may be able to ascertain confidential and sensitive information of market participants because the information could provide insights into individual participant positions. As a small CCP with only a few contracts and a dozen clearing members, these concerns are exacerbated since the possibility of someone being able to deduce proprietary and confidential business information of clearing members is increased. The risk of having confidential business

[1] Section 3.2.14 states that to "help the board discharge its risk-related responsibilities, an FMI should consider the case for a risk committee, responsible for advising the board on the FMI's overall current and future risk tolerance and strategy." The explanatory note then continues on to provide that a CCP should have such a risk committee.

information exposed could lead clearing members to withdraw their membership from smaller CCPs, which may result in additional consolidation both at the futures commission merchant ("FCM") and CCP level.

MGEX challenges the apparent assumption that additional disclosures would necessarily benefit the public or further the purpose of assessing the risk of a CCP and recommends that CPMI-IOSCO keep disclosure requirements aligned with existing regulatory frameworks and the Public Quantitative Disclosure Standards for CCPs. Alternatively, if further disclosures are believed to be beneficial, MGEX suggests CPMI-IOSCO issue principle based, rather than prescriptive, disclosure lists. Furthermore, MGEX urges CPMI-IOSCO to consider the size of a CCP and its relevance to the stability of financial markets when finalizing the disclosure standards. In addition to the risk that clearing members may leave smaller exchanges due to the risk of confidential business information being exposed, what may be sufficient for an extremely large CCP that serves multiple markets may cause harm to a smaller CCP and its markets participants should that CCP be involved with smaller or only a few potential markets. MGEX recommends CPMI-IOSCO consider relief measures for small CCPs since a one size fits all approach may harm both the CCP and its market participants if adopted.

Stress Testing

MGEX agrees that stress testing is fundamental to the risk management framework for a CCP and that rigorous stress testing should be used to determine the amount and test the sufficiency of its financial resources. Specifically, as it relates to constructing scenarios using historical stress events, MGEX agrees with the guidance that a CCP should include relevant peak historic price volatilities[2] when creating its scenarios. MGEX also agrees that there are times when historical scenarios are no longer plausible and should not be used when constructing extreme but plausible stress scenarios, provided there is reasonable justification for the exclusion of those scenarios. MGEX encourages CPMI-IOSCO to continue to allow for this flexibility.

MGEX also agrees that CCPs should be free to run various implausible stress scenarios for informational purposes only which would not be used by the CCP or regulators when determining a CCP's credit and liquidity thresholds.

Paragraphs 3.2.4 and 3.2.14 of the Report state that a "CCP should also develop scenarios that address other potential sources of liquidity risk" or credit losses arising from the default or failure of a "liquidity provider, settlement bank, nostro agent or investment counterparty." While it is important for CCPs to consider the effect stressed market conditions may have on the collateral held, a CCP should not be expected to guarantee the performance of a third party settlement bank or other custodian. MGEX believes this requirement goes beyond the consideration and role of a CCP to guarantee performance of open positions in each market. Moreover, this type of guarantee is not consistent with industry practice for any entity holding collateral on behalf of a customer (e.g. FCM to its customer or CCP to its clearing members).

It is important to note that while the PFMIs emphasize the safety and promote the use of central banks, a number of CCPs in the U.S. do not have access to these types of utilities[3] (the Federal Reserve). Currently, only U.S. CCPs that are designated Financial Market Utilities by the Financial Stability Oversight Council have access to the central bank. As a result, DCOs that do

[2] See paragraph 3.2.30.
[3] See Title VIII Dodd-Frank Act which permits the Federal Reserve to hold accounts for designated Financial Market Utilities.

not have this designation, solely due to their size and complexity, must use commercial settlement banks. This inconsistency is a distinct disadvantage to smaller U.S. DCOs that do not have access to central banks when mitigating their risk against a commercial bank or other custodial failure. Consequently, any requirement to consider a settlement bank or other custodial failure within stress scenarios creates a higher standard for smaller U.S. CCPs that may prevent competition by increasing the barriers to entry for new CCPs.

Further, contemplation of a commercial bank failure within stress test scenarios may require CCPs to hold additional clearing member collateral in order to meet a CCP's coverage requirements. This would increase the collateral exposed to the risk of a settlement bank failure. In addition, by supplying a CCP with additional collateral for a settlement bank failure, clearing members would no longer have access to those funds for variation margin during a stressed market.

Paragraph 3.2.12 notes that CCPs should include potential changes in the size and composition of cleared portfolios within their stress test scenarios. MGEX believes that changes in size and composition of portfolios is best managed through a CCP's intraday monitoring of market exposures and systematic intraday variation margin calls. Including potential changes in the size and composition of stressed portfolios would likely overstate potential stress levels since any new positions would not likely be exposed to the entire hypothetical market fluctuation. Creating scenarios using hypothetical market fluctuations in conjunction with hypothetical changes in size and composition of portfolios would unnecessarily increase calculated exposures and increase costs to market participants above an already stressed market level. As a result, MGEX urges CPMI-IOSCO to revise its guidance to exclude any coverage requirements associated with changes in the size and composition of stressed portfolios.

Coverage

MGEX agrees that the current two-tiered Cover 1/Cover 2 minimum standards are still adequate and appropriate. In the U.S., these standards ensure CCPs hold sufficient financial and liquid resources, and maintaining two standards helps account for the difference between CCPs involved in activities with a more complex risk profile or that are systemically important in multiple jurisdictions and smaller U.S. CCPs. MGEX appreciates the additional guidance provided by CPMI-IOSCO and believes it is sufficient and appropriate.

Margin

MGEX agrees with CPMI-IOSCO's recommendation that the minimum Margin Period of Risk ("MPOR") should not be prescriptive in nature. Prescriptive MPOR requirements can often become arbitrary, which leads to over collecting margin for some contracts and not collecting sufficient margin for others. CCPs should have the flexibility to consider the appropriate risk profile for each product to determine an appropriate MPOR.

CPMI-IOSCO asked for comments on the sufficiency of the guidance provided on procyclicality. MGEX agrees that minimizing procyclical risk should be a consideration within a CCP's margin models. However, MGEX discourages the use of prescriptive guidelines that would generalize the unique characteristics of each product. Doing so may add unintended risks and increase costs to market participants by requiring them to pre-fund for volatility not present in the market at the current time.

CCP Contribution to Losses

MGEX agrees with CPMI-IOSCO that a CCP should expose an amount of its own financial resources to absorb losses resulting from a participant default ahead of non-defaulting participants. As identified in its Rules, a portion of MGEX's own resources would be applied towards losses resulting from a participant default prior to accessing resources of non-defaulting clearing members. MGEX also commends CPMI-IOSCO on recognizing that the amount of a CCP's own contributed resources should be a business decision based on a multitude of factors rather than imposing prescriptive requirements. MGEX is cognizant that a CCP's skin in the game continues to be a highly debated topic, but mandating minimum amounts or thresholds would be especially harmful to small CCPs and may even push them out of the market entirely. MGEX consequently encourages CPMI-IOSCO to leave this decision in the CCP's discretion.

On the whole, MGEX believes the guidance provided on a CCP's contribution to losses is sufficient and appropriate, but MGEX does have two areas of concern. First, according to the guidance, a CCP should contribute its own resources to absorb losses resulting from a participant default and "the custody and investment of participant assets." As MGEX has previously noted, a CCP should not be responsible for guaranteeing the performance of a third party settlement or custodial bank with respect to funds being held, but not invested, at such banks. Requiring a CCP to guarantee a settlement bank's performance would be harmful for a number of reasons, particularly for non-systemically important CCPs who are unable to access the U.S. Federal Reserve, as explained above.[4] MGEX therefore urges CPMI-IOSCO to reconsider whether a CCP should be required to contribute its own resources to absorb losses stemming from a settlement or custodial bank failure.

Second, paragraph 6.2.1 states that in "determining the amount and characteristics [of the resources to be exposed], the CCP should consider the results of engagement with direct and indirect participants and other relevant stakeholders." Although this may be an appropriate suggestion, MGEX questions the necessity of engaging additional participants and including this directive in the Report. A CCP's board of directors is representative of a variety of stakeholders and different viewpoints are thus already considered in determining the appropriate amount of contributed resources. Moreover, even if a CCP gathered additional views from participants and stakeholders, those viewpoints are still susceptible to the issue of self-interest and it is unclear what incentive these stakeholders would have to help a CCP find the right balance of contributed resources when it would favor them for that amount to be as high as possible. Because a CCP should not be beholden to the views of stakeholders when making this critical determination, MGEX recommends CPMI-IOSCO clarify that the extent to which the CCP seeks out and considers additional views be within the discretion of the board of directors.

Recovery Planning

MGEX believes that the additional guidance, in combination with the recovery guidance previously published by CPMI-IOSCO, is sufficient and appropriate and thanks CPMI-IOSCO for its work to help facilitate the development of recovery plans by CCPs.

[4] See paragraphs 3 and 4 of the section on Stress Testing.

MGEX would like to reiterate its appreciation for the opportunity to comment on the Report. Should you have any questions or require further information, please feel free to contact James Facente at jfacente@mgex.com, Jacob Fedje at jfedje@mgex.com, or Lindsay Hopkins at lhopkins@mgex.com.

Sincerely,

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