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Committee on Payments and Market Infrastructures (CPMI)
International Organization of Securities Commissions (IOSCO)

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CPMI-IOSCO Consultative Report 'Resilience and Recovery of Central Counterparties (CCPs): Further Guidance on the PFMI'

Nasdaq Clearing AB (Nasdaq Clearing) is a leading EMIR-authorized CCP providing central counterparty clearing services relating to a broad range of markets and asset classes. Our offering includes clearing of both exchange traded and OTC contracts as well as a repo clearing service.

We appreciate the opportunity to provide comments on the CPMI-IOSCO Consultative Report 'Resilience and Recovery of Central Counterparties (CCPs): Further Guidance on the PFMI' (Consultative Report). Our answers to the questions raised in the cover note to the Consultative Report are set out below.

1. Governance

a) Is the guidance provided on CCPs' governance sufficient and appropriate?

The Board of Directors is ultimately responsible for the company and therefore accountable for the governance and the risk management. The Board of Directors should keep its independence but set the framework for the CCP's risk management, including the margin system, stress testing and liquidity resources. The Board's responsibility and accountability should be clearly defined and should not be confused with the day-to-day management of the CCP. Nasdaq Clearing shares EACH's and CCP12's view on governance.

- b) 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 (or a subset of the list) suggested by an industry group and attached as an Annex be appropriate and sufficient for disclosure and feedback purposes?***

The CPMI-IOSCO's public quantitative disclosures standards for CCPs have been implemented with a good level of detail. Nasdaq Clearing sees no need for further disclosure and does not recommend the disclosure of the items included in the list set out in the Annex. While some information is already disclosed, some information, such as detailed information relating to stress test results, could potentially breach confidentiality provisions vis-a-vis the CCPs' participants.

2. Stress testing

- a) Is the guidance provided on stress testing sufficient and appropriate?***

Nasdaq Clearing is of the opinion that the guidance provided is sufficient and appropriate except for in the areas described below.

Porting of clients

The guidance regarding porting of client accounts (Section 3.2.51) requires that CCPs make the assumption that they will not be able to port client accounts of a defaulted clearing member. The proposed guideline does not differentiate between segregated and non-segregated accounts. The assumption that CCPs will not be able to port segregated client positions is considered to be beyond extreme but plausible and could potentially disincentivize client clearing involving segregated accounts.

We do agree though that non-segregated accounts should not be subject to porting assumptions. The likelihood for a successful porting of such accounts is uncertain or even unlikely due to the fundamental structure of the accounts. However, we do not think it would be appropriate to treat segregated accounts in the same way. Although we recognize that it is not completely certain that segregated clients will find a transferee under stressed market circumstances, it is implausible to assume that all client accounts will have to be liquidated should a clearing member default. The segregated accounts have been designed by CCPs and regulators with the objective to create a robust client account structure which should facilitate successful porting with a high degree of certainty. To require CCPs to use the assumption that segregated client accounts cannot be ported and must be closed out in a default of the clearing member represent a scenario beyond an extreme but plausible one. By treating the segregated accounts the same way as non-segregated accounts, the assumption excludes the following aspects:

- i. the default management process deployed by CCPs;

- ii. CCPs' default experiences involving porting of clients;
- iii. whether or not accounts have margin calculated on a gross or net basis and if collateral is held on segregated accounts;
- iv. that the account holders of the segregated accounts are known to the CCP; and
- v. that many larger clients, which represent the majority of the exposure for CCPs in relation to segregated client accounts, have multiple relationships with potential back-up members.

In order to establish appropriate assumptions which represent an extreme but plausible event and to avoid disincentives for the most robust client clearing structure, we would like to see that the likelihood of successful porting is considered, factoring in the points above. CCPs should be required to demonstrate the basis for porting to their National Competent Authority. However, we also recommend a cap on the maximum number of segregated accounts that can be assumed to be successfully ported.

Stressing collateral values

Section 3.2.46 provides that CCPs should incorporate the stressed value of collateral, including cash collateral that has been invested by the CCP, into its stress testing. Nasdaq Clearing would appreciate guidance on whether or not CCPs are able to use the margin required in the stress tests instead of incorporating collateral amounts held by the CCP. Taking into account the clarifications in the report that state that excess collateral should not be considered and that collateral should be valued under stressed market conditions that are extreme but plausible, Nasdaq Clearing considers that CCPs should be able to use margin requirements in its stress testing. If collateral haircuts are based on the stressed market conditions above, CCPs should be able to assume that collateral values after haircuts cover the margin requirements, thereby justifying the usage of margin requirements in stress testing as prudent risk management.

Liquidity stress scenarios

Section 3.2.29 states that extreme but plausible scenarios used for liquidity stress testing should include all the scenarios used for credit stress testing. Historical scenarios that affect liquidity exposures may be different from those that drive credit exposures. The PFMI should at least allow for modifications to the scenarios used in credit stress testing when applying them to liquidity stress testing.

Offsetting of gains and losses

In Section 3.2.45 it is stated that separate stress scenarios for each specific product category should be considered, with no offsetting of gains and losses permitted across categories in case the joint default management is not possible. Nasdaq Clearing believes that no margin offsets due to correlation benefits should be allowed where there are separate default

management processes, but this should not include offsets of gains and losses. As long as the product categories fall under the same default fund and waterfall resources there is no need to rule out offsets.

a) In the light of the potential for member positions and market prices to change significantly during the day, is the proposed guidance on capturing intraday positions and price movements in stress tests appropriate and sufficient?

The guidance on capturing intraday changes in positions and prices in stress tests is inappropriate. Section 3.2.24 declares that CCPs should consider the effects of how positions may change on an intraday basis, considering the effects of stress scenarios that are based on relevant stressed intraday position changes after the last collection of prefunded financial resources. According to this section, CCPs should consider developments in the size, composition and directionality of participants' positions during the day. Nasdaq Clearing's opinion is that modelling of intraday position changes would push stress test results beyond extreme but plausible and would add uncertainty and model risk to the results, which in turn would make them difficult to interpret and communicate. Instead we suggest that CCPs should manage intraday risk with a strict and transparent intraday margin regime. If CCPs regularly and frequently ensures that no material collateral deficit arises, regardless if such deficit is caused by a change in cleared positions, market prices or collateral value or composition, the overshooting stress scenario risk is contained at immaterial levels in relation to the entire waterfall of resources.

3. Coverage

a) Is the guidance provided on coverage sufficient and appropriate?

The guidance provided on coverage is sufficient and appropriate. We would, however, appreciate a clarification on what the term affiliate means.

Affiliates

The term affiliate should be clarified. It is unclear if the word affiliate includes other legal entities belonging to the same parent company of the defaulting participant. Although it is prudent to assess the effect of including all participants that have a relationship with the defaulting counterparty, the results should not necessarily be used when determining the size of the default fund and the overall level of resources available to the CCP. The CCP should instead assess the likelihood that a default of one participant would trigger a default of another affiliated participant, taking into account credit based factors such as the type of affiliation and the location of the affiliated entities. Nasdaq Clearing bases this recommendation on past default experiences such as the Icelandic financial crisis, where the default of subsidiaries to defaulting Icelandic credit institutions were avoided when the

Nordic subsidiaries were sold and their accounts were transferred to local Nordic banks that were members of Nasdaq Clearing.

b) Is the current two-tiered Cover 1/Cover 2 minimum standard still appropriate in relation to the guidance in the report?

The Cover 1 / Cover 2 minimum standard is still appropriate.

4. Margin

a) Is the guidance provided on margin sufficient and appropriate?

The guidance on margin is sufficient and appropriate. However, with regards to portfolio margining, the regulation should consistently refer to “dependence” rather than “correlation”. In many cases the guidance refers to “dependence” (between risk factors, etc.) which provides a clear understanding of the regulatory requirements. The term “correlation” which is used in some cases is somewhat ambiguous.

b) Is the guidance provided on procyclicality appropriate and sufficient?

The guidance on procyclicality is adequate.

c) The PFMI do not explicitly address margin add-ons. Is the guidance provided on margin add-ons adequate to ensure sufficient coverage by the margin system and other prefunded financial resources in line with the PFMI?

The guidance on margin add-ons is adequate.

d) The PFMI do not prescribe a minimum margin period of risk or closeout period. Is further guidance in this area needed?

Nasdaq Clearing recommends that a global standard is established in order to avoid regulatory arbitrage.

5. CCP contribution to losses

a) Is the guidance provided on a CCP's contributions to financial resources to cover losses sufficient and appropriate?

The guidance is considered sufficient and appropriate.

Please do not hesitate to contact us if you have any questions or require further information.

Yours sincerely,

Nasdaq Clearing AB

A handwritten signature in blue ink, consisting of stylized, overlapping loops and strokes, likely representing the name Fredrik Ekström.

Fredrik Ekström
Chief Executive Officer