Consultation Response
Client Clearing: Access and portability

Thanks for the ability to respond to this extensive paper on client clearing: access and portability. We are grateful to CPMI and IOSCO in engagement on this topic.

General Remarks

We agree with the issues represented by the DAT on concentration issue, lack of certainty re porting and access. We see two key risks associated with client clearing:

- The need to post variation margin in cash. Many buyside clients are limited in how much excess cash they can hold and therefore require an efficiently functioning repo market, especially during periods of market stress.
- The inability to port within short time frames upon either a CCSP default. We do not believe porting risk has reduced in recent years.

We believe it is crucial that - under any clearing model (whether it is a standard client clearing model or sponsored access model) - clients have the ability to extend the porting window by connecting with a CCP directly in the event of CCSP default/termination. This would allow clients to post initial margin (IM) and variation margin (VM) directly to the CCP to support their trades. A multiple of initial margin may be considered during this phase as clients are unlikely to be able to post default fund contribution and make intra-day margin calls. Further consideration may also be needed to ensure that risks and complexity around intra-day margins are addressed appropriately.

Please find below our answers to the specific questions raised at the end of the discussion paper.

Access (Section 2)

Design of direct and sponsored access models

1. *Do you agree with the observation in the discussion paper that the direct and sponsored access models are designed for and generally used more by larger and/or more sophisticated clients?*

Yes, we do agree with the observation that direct and sponsored access models are designed for larger and more sophisticated clients. The set-up is complex. Legally, and operationally the effort to implement these direct and sponsored access models is quite intense. The costs of the implementation are substantial. Once operational, the day-to-day processes are complex and require experienced staff.

2. *Could there be any other solutions that would facilitate access, either through greater use of such access models by small and medium-sized clients, or through some other solution?*

We don't think that a direct or sponsored access model is a market wide solution, due to the intense implementation process, and the additional complexity to the day-to-day processes introduced by the use of these models.

Over the past, we have seen some CCSPs stop providing client clearing services. We would encourage to investigate the reasons why these CCSPs made their decisions to understand whether additional measures would prevent other CCSPs making such decisions. We would also ask to investigate the impact of bank capital rules on providing clearing services to clients and whether calibration of these rules could help to improve the business case of providing client clearing services.

Barriers

3. *Do you agree with the findings in the discussion paper that direct and sponsored access models are used more for certain types of products (eg repos) than for others? Do you agree with the reasons described in the paper for why this is the case? Why/why not?*

We do agree that the direct and/or sponsored access models are mostly used for repo clearing. Repo transactions are short dated instruments and have a very different risk profile compared to long dated OTC derivatives transactions. Next to that, these repo transactions do not belong to a carefully selected portfolio of hedging instruments of strategic importance for which it is essential that they stay alive. For repo transactions this risk is smaller as in general they can be more easily replaced by alternatives.

Challenges related to direct and sponsored access models

4. *Do you agree that direct and sponsored access models have the potential to diversify the risk profile of the direct clearing participant basis of a CCP by introducing new types of direct participants? Why/why not?*

In theory all clients could connect to the CCP through these models, however we could see that the implications of having many (small) clients being a direct member through such models does mean something to the CCPs risk management and to the wider group of members (banks).

5. *Do you think that CCPs have introduced sufficient safeguards to prevent risk transmission from direct participants using direct and sponsored access models? Why/why not? If not, what additional safeguards do you think are necessary?*

6. *Do you think that sponsors are properly incentivised to closely monitor the activity of their sponsored participants (ie the direct participants)? Why/why not? If not, how do you think sponsors could be properly incentivised?*

We believe that sponsors have a clear view on the activities of the direct participants and monitor closely all activities.

7. *Do you think that the number of sponsors is limited? Are you concerned about sponsor concentration risk? If so, is this because it is difficult to find a sponsor? Are there any other reasons?*

The number of sponsors active we are aware of is very limited; we do know a few CCSPs providing the services and some are in the process to make a decision whether or not to provide such services. We understand that providing these services by CCSPs is mainly based upon client demand. Not only is the implementation for direct participants quite intense, the same counts for CCSPs. As the models seems to be designed for more sophisticated clients, the number of CCSPs providing these services could stay limited.

8. *Do you think that CCP rules adequately address the issue of sponsor default? If so, what are the CCP rules that adequately address this issue? If not, what kind of CCP rules are required to address this issue?*

We believe these are adequately addressed.

Testing

9. *Have you participated in default management exercises that test direct and sponsored access models?*

No, we haven't participated, but we would be keen to participate if a CCP at which we are connected with was to initiate this. We believe it would be very helpful to do such exercise as it not only provides insights what will happen at time of a default, but it would also provide an even better and real insights in all the risks associated to the models and could improve our own risk management procedures.

10. *Without providing identifying information, what has worked well in such exercises? What has not? Do you have recommendations as to what could be improved for such exercises?*

We haven't participated in such exercises.

Additional considerations

11. *Please describe any additional factors that may be impacting the activity and uptake of direct and sponsored models that are not considered in this paper.*

The models in place do not provide the ability for clients to connect to the CCP directly in the event of a CCSP default to extend the porting window beyond the standard number of days. In the past, one of the CCPs provided a kind of membership where in the case of a CCSP default, the client would become a member for a short period of time. This opportunity is removed, because of the high KYC requirements and the lengthy process of onboarding. Would such membership still exists, we would opt for this opportunity, even though it would take much time before we are onboarded.

12. *Please provide any additional comments with regards to the impact that direct and sponsored access models have on access to client clearing.*

The direct access model for repo is seen by some as a solution to the issue pension scheme arrangements have raised regarding the provision that VM should be met in cash. We would like to stress that cleared repo only can be considered as another tool in the toolbox to generate cash – in normal and in stressed market circumstances. The Covid-19 turmoil in March 2020 showed that in the cleared repo market the ability to generate cash by buy-side participants was very limited.

13. *Please provide additional comments with regard to access to client clearing more generally.*

The consultation paper notes that: *"For the derivatives markets, while new access models seem to address the regulatory constraints of those client categories which are not allowed to contribute to* *mutualised loss sharing arrangement do no solve the problem of those potential participants that have operational and investment constraints for the active management of liquidity needed for meeting variation margin and intraday calls.".* [1] We do agree that the new access models do not help in the issue that VM calls needs to be met in cash. However, we would like to stress that many buyside do have an active management of liquidity, but they are limited in how much excess cash they can hold and therefore require an efficiently functioning repo market to transform available liquidity into cash, especially during periods of market stress.

Maybe not exactly in relation to the access to client clearing, but we would also like to ask for more transparency amongst CCSPs about their client clearing activities at each CCP. Such transparency would help to better evaluate the CCSPs and to identify any risk of a possible exit of CCSPs from providing client clearing services and accompanied consequences. Each discussion we have with (new) CCSP comes with some statistics how well their service is, but such information is not public available nor is it clear what the statistics are in terms of IM, number of transactions etc. It would be welcomed to have some publicly available information about the client clearing activity.

Porting (Section 3)

Risks from not porting

14. Are there any additional risks or potential harm associated with not porting following a clearing participant default, which were not described in the discussion paper? If so, please describe such additional risks and/or harm.

We would like to stress that for Pension Scheme Arrangements it is essential that hedging portfolios continue to exists under all circumstances. In the event of a default the risk is that without any alternate CCSP the portfolios will be liquidated and PSAs will lose their hedge against their liabilities. During such a period, it will also be very difficult to have a clear view on when and what is liquidated which leaves PSAs unable to try to manage its risks.
Please note that as a consequence of clearing, PSAs will only have a limited amount of CCSPs and therefore run relative large concentration risks. If a CCSP were to default and no back-up CCSP can be found, PSAs will lose a relatively large part of their hedging portfolio with potentially large losses and with direct impact on their coverage ratio and effect on the ultimate pensioners.

15. Potentially effective practices. Do you agree with the two tools identified in the discussion paper as potentially successful porting practices? Are there any other tools that should be identified as potentially effective practices?

In theory we do agree with the two tools identified in the discussion paper. However, in our experience CCSPs are not willing to act as a backup clearing member – which we do understand. We believe that the alternate CCSP should be an active CCSP of a client as upon an event of default, market circumstances are most probably very volatile and stressed. It would mean that the VM calls can be large and intra-day calls can be issued as well. It is our experience that it takes quite some testing and implementation steps before a clearing member is actually operational. Should there be no relationship in place between the client and an alternate CCSP, there is a high risk that clients cannot meet their obligations due to the operational setup which is not properly in place yet.

[1] A discussion paper on client clearing: access and portability, page 5

16. *What additional approaches do CCPs use to pre-emptively identify a backup CCSP? What incentives can be provided to assist the development of alternative/backup CCSP relationships? Are there any other considerations for alternate/backup CCSPs not set forth in the report?*

As we understand, providing client clearing services is quite balance sheet intensive. We would like to ask to investigate whether capital rules needs to be calibrated to make it more attractive to CCSPs to also function as a backup CCSP.

17. *Are there other considerations for having a game plan that were not described in the discussion paper?*

We are supportive of any plans that CCPs are able to develop that enable successful porting.

18. *In addition to those outlined in the paper, what attributes of account structures facilitate or impede porting client accounts?*

The discussion paper notes that some CCPs permit clients to make direct payments. We would like to stress that such a ability should be in place for all CCPs as we believe that if a client can make direct payments to the CCP, more time is available to port all positions.

19. *Are some client accounts not suitable for porting?*

We mainly make use of individual segregated accounts, which we believe are suitable for porting.

20. *Does holding excess collateral and the ability to make direct payments improve the probability that a client will be ported successfully or are there impediments to using this collateral?*

We do believe that excess collateral and the ability to make direct payments to the CCP improve the portability. We would like to stress that this excess collateral should always belong to the client (asset protection) and should not be at risk in case of a default of a CCSP. We believe that direct payments could extend the porting window to port the positions to another CCSP.

21. *What is your view of a client consent mechanism that could be used to facilitate porting, if permitted under applicable law?*

Our CCSPs are selected after a RFI/RFP process and the CCSPs are part of our risk management framework. We would think that a client consent mechanism would work, but we would also like to understand to which CCSP our positions will be ported.

22. *Are the potentially effective practices described in the discussion paper consistent with prior porting experiences?*

We only tested BAU-porting multiple times ourselves and we do not have any experience in porting in event of default.

23. *Are there any barriers to implementing potentially effective porting practices that are not described in the discussion paper?*

Communication and coordination

24. Are there any additional communications by the CCP or the defaulting CCSP that may increase the probability of porting client accounts?

We would like to stress that any available information should be provided. As buy side client we experience that not all information is made available due to confidentiality issues.

25. *Are there additional actions CCPs can take following a clearing participant default to coordinate that are not set forth in the discussion paper? Are there any limitations on coordination that are not included in the paper?*

In the event of a default, we would like to have a clear view on all activities that are performed with our portfolios. It is crucial to know whether our portfolio is ported, or whether our portfolio still is at risk?

Harmonisation

26. Are there additional items CCPs can harmonise or standardise during business as usual that are not outlined in the discussion paper? Are there any factors that may impede harmonisation or standardisation that are not provided in the paper?

We do not see additional items that can be harmonised, each CCP has its own procedures which makes further harmonisation complicated.

Notable issues to consider when developing a porting protocol

27. Are there additional regulatory requirements that could impede porting? Can such impediments be addressed or mitigated through action prior to the CCSP's default?

The items mentioned in the discussion paper being barriers like KYC/AML requirements and capital requirements could indeed impede porting. It could help if CCSPs could rely on the KYC processes performed on clients by other CCSP, but on the other hand a CCSPs own risk management would perform their own checks and balances before providing clients access to a CCP. As mentioned before, it would be good to investigate the impact capital requirements have on providing client clearing services and whether calibration could provide further capacity.

28. Are there any additional factors that should be addressed in testing exercises?

We haven't participated in any testing exercises yet, which makes it difficult to come up with additional factors that should be addressed.

29. Please provide examples of good disclosure practices from your perspective.

There are tools available on which market participants can provide KYC documentation.

30. *Are there other arrangements a CCSP can make to ensure that, post default, the CCSP can help coordinate porting at multiple CCPs if the CCSP is a non-defaulter? If the CCSP defaults, what arrangements can the CCSP make to facilitate the porting of its clients?*

None of the CCSPs we have onboarded, has agreed to guaranteed porting in or out. The reason for that comes down to the risk CCSPs run on the client transactions and the capital requirements that comes with the client transactions. In one way we can understand this position, but even a promise to help a clients is not in place. It remains to be seen what will happen in the event of a default.

Suggested next steps

31. *Please provide feedback on the suggested next steps for consideration. Do you agree that these issues warrant further consideration by CCPs, CCSPs and/or clients? Are there additional issues that may warrant further consideration?*

We think it is crucial to successful porting that the porting window will be extended and we believe that one of the solution to do so is the allowance of clients to post VM and IM directly to the CCP. We understand that this will complicate the modus operandi of a CCP just in times of stress – as CCPs cannot take directly funds from these clients, as they normally do from CCSPs in order to collect VM(/IM). We encourage policy makers to consider this option next to the suggested steps mentioned in the discussion paper.