



asset management group

22 September 2017

CPMI Secretariat
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IOSCO Secretariat
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Re: **Consultative Report on Framework for Supervisory Stress Testing of Central Counterparties (the “Consultative Report”) by the Committee on Payments and Market Infrastructures (“CPMI”) and the Board of the International Organization of Securities Commissions (“IOSCO”)**

Dear Secretariats:

The Asset Management Group of the Securities Industry and Financial Markets Association (“**SIFMA AMG**” or “**AMG**”)¹ appreciates the important work of CPMI and IOSCO in formulating principles for supervisory stress tests (“**SSTs**”) of central counterparties (“**CCPs**”). We believe that the framework proposed in the Consultative Report along with the interdependency study recently completed by global regulatory bodies² appropriately prioritizes the need to understand risks arising from the interconnectedness within the central clearing system. AMG believes that this understanding of risks, coupled with corrective actions, will improve protection of customers such as pension funds and retail funds whom asset managers serve as fiduciaries.

AMG generally agrees with the approach taken by CPMI and IOSCO to establish a framework for SSTs and offers comments to further advance CPMI and IOSCO’s goals in establishing this framework. An important, common theme in our comments below is the need for SSTs, in addition to assessing vulnerabilities across CCPs to a common stress event, to take steps with CCPs to address the identified risks, overseen by the authorities responsible for the CCP(s) where vulnerabilities are identified. We believe that this logical step must be made explicit in the final standards because the true value of SSTs to customers will come from correcting identified credit or liquidity shortfalls. Explicitly including remediation as a purpose of SSTs also resolves a number of difficult issues with which the Consultative Report grapples, from design to disclosure. Further, it helps with the balancing of costs with benefits, avoiding “mission creep” in what could

¹ SIFMA AMG brings the asset management community together to provide views on policy matters and to create industry best practices. SIFMA AMG’s members represent U.S. and multinational asset management firms whose combined global assets under management exceed \$39 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds.

² Basel Committee on Banking Supervision (“BCBS”), CPMI, the Financial Stability Board (“FSB”) and IOSCO, *Analysis of Clearing Interdependencies* (5 July 2017), available at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD570.pdf> (the “Interdependency Study”).

become an academic exercise and addressing some of the risks identified in the Interdependency Study.

AMG provides the following recommendations:

1. The SST Framework Should Include Additional Options that Will Improve Simulation of Market Realities

AMG believes that SSTs, in testing for macro credit and liquidity risks, should use extreme but plausible scenarios that may include a sequence of stress events, as opposed to tests that are limited to a single event. Market participants and regulators know all too well that a financial crisis does not typically begin and end with a single market event. Rather, an initial event results in weaknesses being realized by cascading failures caused by liquidity and asset shortfalls. While we recognize that sequential SST scenarios are more complex to run, we believe that the macro focus helps to counterbalance the difficulty of accomplishing this analysis. As with other components included in the framework, using a series of events should be on the list of potential options from which regulators can select to design the SST.

AMG also believes that SSTs should simulate market realities by expanding the list of interdependencies that authorities may use in the assessment. SSTs should include consideration of: a) specific markets and products cleared; b) currencies in which the products are cleared; c) number and concentration of CCPs, clearing members and other participants; d) overlap of liquidity providers across CCPs; e) dual-hatted liquidity providers (e.g., institution serving as both liquidity provider and clearing member); and e) overlap across CCPs of service providers (e.g., custodians).

2. SSTs Should Have the Dual Purpose of Uncovering Risks *and* Remediating those Risks at Either a CCP or Multi-CCP Level

AMG believes that SSTs should be expressly paired with remediation of any identified credit and liquidity risks in the system overall and, as applicable, in individual CCPs whose performance demonstrates weaknesses. The principle reason for running multi-CCP SSTs is to gain the ability to comprehensively and systemically assess risks to the clearing system before those risks become realities. Significant market events impact the financial system overall. SSTs will provide clarity on how the system overall and CCPs individually may weather a common stress event—in other words, how resilient is the system overall and how resilient is each CCP as part of that system under a common stress event. Rather than paying the price of failure in a future crisis, we believe that expressly connecting SST results with having the relevant authorities oversee remediation of identified risks will strengthen protection of customer assets and, relatedly, increase market confidence in clearing.

Remediation, while principles-based, needs to meaningfully address insufficiencies of resources to avoid harm to customers who have no control over how a CCP manages its risks. As outlined in the Consultative Report, SSTs will focus “on the potential losses that the set of CCPs may face in a stressed event, the amount of resources available to the in-scope CCPs, and the mutualized losses that may need to be covered by clearing participants” and on “liquidity outflows of the in-scope CCPs, the liquidity resources available to the CCPs, and the liquidity calls made to

clearing participants or other third parties during a stress event.”³ Alternatively, the SST could be defined in terms of identifying “vulnerabilities that could create financial losses or large, unexpected liquidity outflows at CCPs, non-defaulting clearing participants or other third parties.”⁴ Either way, the SST will quantify resource shortfalls. These resource shortfalls must be remedied. While we agree with CPMI and IOSCO that SSTs should not replace individual CCP stress tests and that “the tests are not specifically designed to establish minimum requirements for individual CCPs,”⁵ resource shortfalls revealed at the individual CCP level should not be ignored and should be remediated. Whether the perceived insufficiencies are located within under-resourced default funds of a single CCP or standby credit facilities across CCPs, those resources need to be put into the system to maintain a protective layer between CCP losses and assets of clearing members’ customers (e.g., pension funds, retail funds). Extreme remedies that could result in the taking of a portion of non-defaulting customers’ property need to remain as remote as possible.⁶ These customers, on whose behalf asset managers act as fiduciaries, are not involved in the risk management decisions of the CCPs and, for products subject to a clearing mandate, are subject to a regulatory directive to clear. Their assets should not be put at risk, particularly when those risks are identified through an SST.

3. Authorities Should Consider Seeking Input from Various Market Participants in Designing SSTs

We believe that the SST framework should suggest, but not require, that authorities consult a range of market participants and CCPs. Consistent with CPMI and IOSCO’s Further Guidance on the Principles for Financial Market Infrastructure,⁷ we believe that input from market participants—including non-clearing members—may result in better designed SSTs. However, we believe that authorities should use their discretion on whether to seek input.

4. SSTs Should be Run Cross-Jurisdictionally at Least Annually

AMG believes that regulators should work cross-jurisdictionally to harmonize SSTs that are performed, not only to reduce costs but also to understand any cross-border risks that are present and must be remediated. Derivatives continue to trade and clear in a global marketplace. As such, jurisdiction-specific SSTs may not reveal all material weaknesses.

³ Consultative Report at para 25.

⁴ Consultative Report at para 26.

⁵ Consultative Report at para 10.

⁶ AMG has never supported a CCPs using customer assets as a loss allocation tool and believes that the mutualization of loss through taking non-defaulting customer property is an extraordinary measure. AMG strongly believes that the authorities in each jurisdiction should prohibit a troubled CCP from overriding customer protections and taking customer assets.

⁷ CPMI and IOSCO, *Resilience of Central Counterparties (CCPs): Further Guidance on the PFMI – Final Report* (5 July 2017), available at: <http://www.bis.org/cpmi/publ/d163.htm>.

While we recognize the legal constraints around information-sharing of confidential information across jurisdictions, we urge regulators to work together to design coordinated SSTs that will facilitate comparison of results. We further urge regulators to secure the information used given the confidentiality and sensitivity of the underlying data. Secure submission, use, storage, cyber security and protection from disclosure will be crucial.

We further believe that multi-CCP SSTs should be conducted at least annually with flexibility for regulators to conduct SSTs more regularly if additional SSTs would improve risk management across the system, increase regulators' insights into risks that must be managed, and provide a tool for regulators to better understand emerging issues that cannot be assessed adequately by individual CCP stress tests, among other reasons.

5. SST Results Should be Publicly Disclosed and Coupled with Specific Disclosure of Remediation Steps

AMG believes that general disclosures of SST results and specific disclosure of remediation steps should be made public to inform market participants of the risks identified by the SST and how those risks will be addressed. We fully agree with CPMI and IOSCO's conclusions that authorities should protect non-public information. At the same time, meaningful information can be provided to market participants without risking confidentiality. We agree with CPMI and IOSCO that "transparency of supervisory stress testing by authorities can advance the overall objective of a multi-CCP stress test by providing a range of stakeholders with a broad understanding of the macroprudential implications of an extreme but plausible credit or liquidity stress event,"⁸ and believe this benefit be credited in weighing the cost of SSTs.

While the Consultative Report suggests that public disclosure may be avoided or delayed if disclosure would exacerbate market stress, we believe this step is unnecessary if SSTs are coupled with remediation. Withholding disclosure without remediation leaves customers' assets exposed to risks that are known to authorities but unknown to customers.

AMG believes that the disclosure should include:

- a) **A general description of the common event used in the SST.** While AMG does not advocate for detailed disclosure of the scenario used, we do not believe that a general description will risk the confidential information used in the SST or the ability to conduct robust SSTs in the future.
- b) **A general description of any qualitative conclusions reached (i.e., "lessons learned").**
- c) **A general description of resource shortfalls** (e.g., insufficiencies in default fund), either specific to certain CCPs or overall, depending upon the conclusion reached.
- d) **Specific disclosure of remediation steps.** In addition to providing reassurance to market participants that weaknesses have been addressed, we believe that specific

⁸ Consultative Report at para. 183.

public disclosure will provide additional incentives to individual CCPs to identify and remediate issues voluntarily, prior to the risk being identified by SSTs.

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AMG looks forward to participating in future discussions on SSTs and are available to discuss these comments. Should you have any questions, please contact Tim Cameron at 202-962-7447 or tcameron@sifma.org, or Laura Martin at 212-313-1176 or lmartin@sifma.org.

Respectfully submitted,



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