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Dear Mr Tanzer and Mr Heller,

**Guidance on the application of the 2004 CPSS-IOSCO Recommendations  
for Central Counterparties to OTC derivatives CCPs**

**General remarks**

1. The International Banking Federation (IBFed) shares the Committee on Payment and Settlement Systems' (CPSS) and International Organization of Securities Commissions' (IOSCO) view that greater use of Central Counterparties (CCPs) for over-the-counter (OTC) derivatives markets needs to be encouraged. The global dealer industry has already committed itself to ambitious targets for central clearing in various classes of OTC derivatives' contracts<sup>1</sup>. Dealers' progress on central clearing within the boundaries of what is possible (i.e. for CCP-eligible contracts) has been recently recognised by the Financial Stability Board<sup>2</sup>.

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<sup>1</sup> In a March 2010 letter<sup>1</sup> to the Federal Reserve Bank of New York (FRBNY), 15 major OTC derivatives dealers set specific, enhanced target levels for expanding central clearing for OTC credit and interest rate derivatives. These commitments include, for example, central clearing of 95% of new clearing-eligible interest rate contracts trades, and 85% of historical eligible interest rate trades (calculated on a notional basis).  
See at: [http://www.newyorkfed.org/newsevents/news/markets/2010/100301\\_table.pdf](http://www.newyorkfed.org/newsevents/news/markets/2010/100301_table.pdf)

<sup>2</sup> [http://www.financialstabilityboard.org/publications/r\\_100419.pdf](http://www.financialstabilityboard.org/publications/r_100419.pdf)

2. The banking industry's willingness and ability to restructure calls for the establishment of robust market infrastructures in the OTC derivatives space. As a consequence, the Federation is very supportive of guidance that helps CCPs address the issues they face as they operate in these markets. The Federation recalls, however that CCPs have their specificities compared to other financial market infrastructures (for example, payments systems, securities settlement systems and trade repositories) and that, consequently, guidance for OTC derivatives CCPs cannot be incorporated without the necessary adjustment to guidance for other market infrastructures.
  3. The Federation believes that structured and regular dialogue between the market infrastructures' providers, users, and public policy officials is proving its worth. This dialogue should continue to fashion consensual regulatory solutions that reward open approaches and that support the smooth implementation of those solutions.
  4. The Federation is in broad agreement with most of the 15 CPSS-IOSCO recommendations. The specific comments below refer to certain aspects where the Federation is, however, more critical of the suggested guidance. The Federation's comments are fundamentally made from the perspective of that of participants in OTC derivatives CCPs.
  5. A first preliminary remark refers to the scope of the report. While IOSCO-CPSS have clarified that "*issues applicable to CCPs and other types of financial market infrastructures are not discussed in this report (...) including the use of central bank money*", the Federation considers that such an issue deserves careful and proper reflection and will certainly need to be considered in the context of a comprehensive review of CCPs and those market infrastructures.
  6. A preliminary remark refers to one of the distinctive features of OTC derivatives as identified in the paper: market transparency (page 9). Under this item, the Federation considers that CPSS-IOSCO bundle two different ideas: a) transaction transparency, that refers to public availability of information regarding prices and volumes of financial transactions and b) transparency of risks taken by market participants. Whilst the Federation is supportive of providing the supervisory community with the necessary information to ensure the stability of OTC derivatives markets, it opposes the link that the document establishes between the level of market transparency in OTC derivatives markets and the development of centralised trading infrastructures in those markets.
  7. The Federation believes that owing to the very same specific features of the OTC markets, no "one-size-fits-all" approach should be promoted. Indeed, market participants' desire for more transparency is inviting greater automation of the search or negotiation process; the provision by information vendors of price sources for key components of the contract; and the development of indexes or benchmarks using panels of dealers to supply quotes on comparable terms. With this in mind, the Federation considers that the implementation of CCPs for OTC derivatives markets needs to be based on a number of considerations specific to the particular market in terms of whether CCP will enhance transparency and promote trading efficiencies without imposing undue and prohibitive costs on transactions.
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### Specific remarks on the guidance

8. In guidance 6.1 (page 17), CPSS-IOSCO suggest that, in a situation of market stress, the CCP “*may need to consider - having participants sign up ex ante to bid in an auction of the defaulting participant’s portfolio, and, in extremis (. if the auction process fails), accept an allocation of the portfolio to surviving participants*”<sup>3</sup>. The Federation notes that:
- This approach is a departure from that in normal market circumstances (guidance 3, page 12) where it is stated that “*non-defaulting participants would not be exposed to losses that they cannot anticipate or control*”.
  - Such a provision makes participants’ management of their own risk extremely difficult, and, eventually, would render the interpositioning role of the CCP useless.
  - The forced allocation of a default participant’s portfolio to surviving participants is likely to trigger snowballing defaults (i.e. domino effect).
  - This approach is an open invitation for the CCP to establish waterfall processes that are skewed in favour of the protection of the CCP’s commercial interest rather than in favour of the interest of its participants.
9. The Federation considers that a better alternative could be the establishment of some kind of external support scheme that would come into play in a situation where the management of a crisis situation exhausts all the CCP’s previous lines of defence.
10. Furthermore, the Federation considers that the recommendation to arrange *ex ante* the secondment of traders from surviving participants to assist the CCP in hedging and close-out procedures in situations of market stress deserves careful analysis. The Federation considers that CCPs should be commercially-driven organisations, hence responsible for the quality of the service they provide to their clients, for the arrangement of the necessary resources to deliver that service and, ultimately, accountable to their shareholders.
11. In connection to guidance 6.4 (page 18), the Federation considers that, if a CCP allows the segregation of positions and collateral of customers, then the provision of this facility may be offered by the clearing member provided it makes commercial sense. With respect to the use of collateral, whilst the Federation considers that it is appropriate that the CCP states clearly whether or not it is able to make use of customers’ collateral, the Federation considers that CCPs should only use it if the participants default. Other uses – for example, to enhance a CCP’s revenues, may give rise to unexpected risks in case the securities lender runs into difficulties (i.e. bankruptcy).
12. Under guidance 8.2 (page 21), CPSS-IOSCO openly contemplates the possibility that OTC derivatives CCP establish links with other venues (i.e. interoperability). The Federation strongly agrees with the limitation of CPSS-IOSCO to links with other types

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<sup>3</sup> Whilst acknowledging that this consultation paper relates to guidance on OTC derivatives CCPs, the Federation highlights that, in the case the defaulting participant’s portfolio is in listed derivatives, equities and/or bonds, remaining open positions should be allocated to that participant.

of market infrastructures. Interoperability links with other CCPs could be a source of additional risks, as recently recognised by regulators. This is even more so for derivatives. While an appealing concept theoretically, the Federation believes that ample experience with interoperability for cash securities has to be gained before analysing a possible extension to derivatives. These comments are also relevant for CPSS-IOSCO recommendations under guidance 12.2 (page 22).

13. With regard to guidance 13.1 and 13.3 (pages 23 and 24), the Federation is concerned by the laxity of the governance arrangements envisaged around the representation of the interest of participants in the CCP. Guidance 13.1 says that a CCP's governance arrangements should be designed in such a way that the interests of the participants will be given "*due consideration*" whereas guidance 13.3 says that the decision to clear additional OTC derivatives will be made by the CCP's decision-making body (i.e. Board) "*with appropriate consultation with user representatives*". The Federation considers that OTC derivatives CCPs must have a Risk Committee comprising the CCPs' participants (including indirect participants), in a proportion that is commensurate to the risk derived from the possible failure of the CCP. Furthermore, the Federation considers that decisions of the Risk Committee, within its areas of responsibility (e.g. the CCPs' risk management function, including possible expansion of CCPs' clearing activity) must be binding for the CCP because the clearing members bear the ultimate risk through their contributions.
14. In connection to guidance 14.1 (page 25) and guidance 15.1 (page 26), the Federation considers that, against the background of OTC derivatives CCPs serving a global market, there is a role for international standards setters, notably IOSCO, to draft common standards for data representation and delivery in order to support proper aggregation of the data and consistent analysis across reporting CCPs.

## Conclusion

15. The Federation considers that the proposed CPSS-IOSCO guidance is broadly adequate. The Federation would, however, recommend that the CCP's governance arrangements more clearly recognise the interest of participants in the CCP and that decisions concerning risk management are taken by the CCP only if endorsed by the respective user-populated Risk Committee. The Federation also feels that the guidance allows CCPs to place a disproportionate burden on non-defaulting participants in situations of market stress resulting from a participant's default. This situation could be addressed by the establishment of some kind of external support scheme for the CCP.

Yours sincerely,



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