European Association of CCP Clearing Houses

Response to CPSS-IOSCO Consultative report on Principles for financial market infrastructures – March 2011

Date: 19 July 2011

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EACH
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EACH – the European Association of Central Counterparty Clearing Houses – has a long history in promotion of Risk Management Standards: In November 2001 EACH issued the seminal «*Standards of Risk Management Control used by European Central Counterparty Clearing Houses*» with the aim of stimulating associated clearinghouses to provide an objective disclosure of their risk controls and of their fulfilment of the Standards.

The EACH Standards were subsequently recognised and cross-referenced by CPSS-IOSCO, ESCB-CESR, the European Central Bank and by the European Commission. In November 2009 the EACH Standards were superseded by the new EACH Supplementary Risk Recommendations.

In July 2007 EACH established its Risk Management Committee with the purpose to ensure ongoing communication between its members on risk management issues, to discuss and analyse Risk Management techniques and developments, and general risk management issues

Background

A.1 The consultative report on Principles for Financial Market Infrastructures was prepared by the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO). The CPSS and IOSCO request comments on the proposed principles in the consultative report by 29 July 2011. After the consultation period, the CPSS and IOSCO will review all comments received and publish a final report in early 2012.

A.2 When finalised, the principles in the consultative report will replace the existing CPSS and CPSS-IOSCO standards for systemically important payment systems, central securities depositories, securities settlement systems, central counterparties and trade repositories, collectively referred to as Financial Market Infrastructures or "FMIs". The current standards are:

- the Core principles for systemically important payment systems (issued in 2001);
- the Recommendations for securities settlement systems (issued in 2001); and
- the Recommendations for central counterparties (issued in 2004).

A.3 Relevant authorities will strive to include the principles as appropriate in their legal and regulatory frameworks by the end of 2012. Authorities will be expected to apply the principles as part of their regulatory, supervisory and oversight activities as soon as possible. FMIs will be expected to take appropriate and swift action in order to meet the principles. Against this background, the CPSS and IOSCO also request input on how quickly FMIs will be able to implement the changes necessary to increase their resilience consistent with the new principles.

A.4 While the CPSS and IOSCO request comments on all the proposed principles, they have also formulated a number of specific questions on which they have requested comments. These questions pertain to Principles 4 (credit risk), 7 (liquidity risk), 14 (segregation and portability), 15 (general business risk), and 18-20 (access and interoperability).

General comments

B.1 In this paper we provide our comments per Principle and where applicable per Key Consideration or per Paragraph. However, we first provide some general observations and comments on the text of the Consultative report.

Applicability to all types of FMI

B.2 CPSS-IOSCO has chosen to incorporate the principles for the different types of market infrastructures into one single document rather than in separate documents per type of market infrastructure. However, when studying the Principles document we have noticed in several instances that this approach can lead to confusion and uncertainty on the question whether a certain paragraph or phrase should be considered as relevant for a CCP. Some examples are:

- 3.5.7 on collateral management systems,
- 3.7.6 (e.g. is the sentence: "*An FMI that employs a DNS mechanism may be able to reduce its or its participants' liquidity risk by using alternative settlement designs, such as new RTGS designs with liquidity-saving features or a continuous or extremely frequent batch settlement system*" applicable also to CCPs?),
- 3.7.16 (e.g.: the statement: "…*process of replenish any liquid resources it may employ during a stress event*…" if referred to a CCP, seems to be applicable exclusively to the injection of liquidity in the Settlement System, or are other interpretations?)
- 3.8.3 (e.g.: the sentence: "*An FMI that does not provide final settlement on the value date (or same-day settlement) would not satisfy this principle even if the settlement date of the transaction is adjusted back to the value date after the settlement*." applies also to CCPs?)
- 3.8.4, 3.8.5 and 3.8.6
- Principle 12

B.3 We recommend that in each Principle there is greater recognition of the specific applicability to each type of FMI. For example, the approach taken in Principle 20 (FMI links) of clearly differentiating specific applications to types of FMI could usefully be adopted more generally.

Relationship between these Principles and legislation

B.4 In a number of cases we have noticed a difference between the CPSS-IOSCO Principles and EMIR. Given the different jurisdictions for which the CPSS-IOSCO Principles on the one hand and EMIR on the other hand are applicable, we want to highlight the risk of regulatory arbitrage against CCPs between jurisdictions.

B.5 In this context we would also like to raise the issue of the ESCB/CESR Recommendations, which currently form the basis for supervision and oversight in the European Economic Area (EEA). We strongly encourage one single set of principles to apply for European CCPs in order to prevent duplication of work and the risk of inconsistent or even conflicting requirements.

Relationship between these Principles and Basel capital adequacy rules

B.6 The link which has been created between the CPSS-IOSCO Principles and Basel III, whereby entities subject to Basel capital adequacy rules may only be subject to the specific treatment of exposures to a CCP if the CCP is deemed a “Qualifying CCP”, makes it extremely important for CCPs to comply with the Principles. A CCP which is not considered to be a “Qualifying CCP” under Basel III may well lose its economic viability. It is therefore key that an objective and fully transparent assessment process is put in place. This starts with full clarity in the text of the Principles. The text of the CPSS-IOSCO Principles contains, apart from the principles themselves, key considerations, a substantial amount of explanatory text and a number of annexes. More clarity should be given inside the document as to which parts of the text comprise the *actual* standards a CCP would need to comply with in order to be considered observant with the CPSS-IOSCO Principles. In other words: which are the minimum requirements a CCP should comply with and what are explanatory comments. In this respect a question also arises about the status of the annexes to the principles (for example Annex E); do they contain requirements CCPs would be assessed against? In addition to this, it is equally important that clarity is provided on which are the competent authorities that will perform the assessment and determine whether a CCP complies with the Principles. Given the requirements from Basel III to comply with the principles, appeal procedures should exist for CCPs which want to contest (parts of) the evaluation.

B.7 It may be worth noting here that compliance with CPSS-IOSCO principles has a different impact on the different kinds of financial market infrastructures; while it is crucial for CCPs for the reasons expressed above, it may have different impacts on other financial infrastructures, which adds another reason for us to question whether it is opportune to have a single set of principles (save for the 6 remaining RSSS marketwide recommendations in Annex C which were not included in the review of standards of CPSS-IOSCO) applying to different FMIs with different implications

B.8 Related to this is the foreseen timetable for assessment. Basel III is expected to come into force on January 1st, 2013. Given that the final CPSS-IOSCO document is scheduled for the beginning of 2012, this appears to leave very limited time for the CCPs to take the necessary actions to achieve compliance – cumulatively, the Principles represent a significantly increased burden on CCPs – and for the appointed assessors to perform their assessments (particularly given the large number and wide range of these assessments). In addition, we want to highlight here that at this moment the procedure for being recognised as a qualifying CCP for Basel III is not yet clear.

Relationship between a CCP, its members, and their clients

B.9 The vast majority of CCPs maintain a principal-to-principal relationship with their participants. This implies that a legal relationship – and therefore legal and financial obligations – only exists between the CCP and its direct participants. The risk of failure of the clearing members’ clients is borne by the clearing members themselves. The underlying reason for this structure is to protect CCPs from the risk of failure of the clients of their participants. In this sense the clearing members (direct participants) provide an additional level of protection for the

CCP through their own risk management and their own margin requirements and collateral buffers.

B.10 On the other hand, it means that the customers of a clearing member are exposed to the default of their clearing member. We understand the current tendency in regulation to better protect customers against the failure of their clearing member. This should, however, not lead to an imposed erosion of the principal-to-principal risk structure protecting the CCPs. Those CCPs which have currently opted for a principal-to-principal structure should not be obliged to accept a direct risk on the clearing members' customers nor any extensive duty of care for these customers.

B.11 A major strength of the principal-to-principal structure is that clients assess the resilience and creditworthiness of their clearing members as a primary consideration in the selection process, and typically perform rigorous due diligence in this regard. A structure whereby clients perceive they are fully protected from clearing member failure would remove this market discipline – clearing members would increasingly compete on price rather than on resilience. This would lead to a significant increase in systemic risk: CCPs are strengthened by robust and resilient clearing members. Whilst a CCP can impose standards in this regard, there is no replacement for market discipline and due diligence being exercised by clients.

B.12 In operational and legal terms it should be noted that this principal-to-principal structure implies that the CCP does not hold collateral provided by the clearing members' clients. Collateral is deposited at the CCP by the clearing members to cover the margin requirements of their clients. This collateral may cover the sum of the individual clients' margin requirements (gross margin) or the margin requirement corresponding with the net position of the clients of the clearing member (net margin). It should be noted that even in the case of gross margin the *actual* collateral deposited by the clearing member at the CCP may differ from the collateral which has been provided by the client to the clearing member. In our view these legal and operational constraints should be made more explicit within the Principles.

B.13 Another consequence of this structure is that CCPs cannot impose (let alone enforce) any requirements on the clients of their clearing members, nor can they control the activity of these clients since there is no legal relationship on which to base such actions.

Wide obligations placed on CCPs

B.14 The document requires in several Principles (e.g. Principles 3, 7, 17) that CCPs should measure, investigate and even manage the risks they pose to the institutions and markets they serve. We would like to stress that CCPs should observe the very highest standards of prudence, robustness, and safety, and have the most sound risk management frameworks. CCPs should do all they can to ensure that they pose as little risk as possible to other parties; they should indeed be aware of any residual risks to other parties but the implication that it is acceptable for CCPs to pose significant risks (even if managed) is not one that we support. In addition to this, all market participants should be responsible for their own risks; furthermore Supervisors and Overseers should have the responsibility for measuring and mitigating systemic risks.

Validation of CCPs' policies

B.15 In several instances the Principles require CCPs to perform or obtain validations. The Principles use different qualifications for the validations required; in some cases validation should be performed *"independently"*, sometimes by a *"qualified and independent party"*, sometimes no conditions are given regarding the performance of the validation. The current text of the Principles does not provide any explicit definition of these qualifications. It would be helpful if definitions were incorporated in the Principles.

B.16 At the moment it is our understanding that (a) a validation which is labelled as performed by a *"qualified and independent party"* should generally be done by an external expert or firm (in our view a qualified and independent party *could* refer to an internal expert independent of the function responsible for the policy in question, but this is unlikely to be practical), (b) a validation which is simply labelled as performed *"independently"* can be performed by an internal specialist or team independent of the team which is responsible for the object to be validated and the results should be reported to the risk committee; however we assume the validator(s) should also be "qualified" so see little difference from case (a) and (c) other validations can be performed by the team responsible for the object to be validated.

B.17 In this connection we assume that the reference to "validation" of models and parameters by competent authorities in EMIR means "approval" rather than the same form of "validation" sought by CPSS-IOSCO, but this is a matter for the relevant European authorities.

"Current exposure" and "Potential Future Exposure"

B.18 The Principles make reference to "current exposure" and "potential future exposure". Annex H defines "current exposure" as "*The loss that an FMI (...) would immediately face if a participant defaulted"*. This current exposure is covered by variation margin (*"Margin that is collected and typically paid out to reflect current exposures"* – definition in Annex H) – and only partially and temporarily by initial margin until variation margin is settled.

B.19 We would expect to see a similar relationship between "potential future exposure" and "initial margin". The definition provided for "potential future exposure" is*: "Any potential credit exposure that an FMI could face at a future date (such as the additional exposure that an FMI might potentially assume during the life of a contract or set of contracts beyond the current replacement cost)".* We assume that this "potential future exposure" refers to the potential liquidation costs which exceed the current replacement cost. In our opinion the term "potential future liquidation costs" is more suitable for this purpose and we therefore recommend using this wording.

B.20 Furthermore, we would expect to see a clearer distinction between the potential future exposure arising under normal market conditions, which CCPs cover through Initial Margin, and the potential future exposure under extreme but plausible conditions, which CCPs cover through default fund and other financial resources. This important distinction is explored further in our commentary on Credit Risk (P4) and Margin (P6), below.

EACH
European Association of CCP Clearing Houses

Principle 1: Legal Basis

1.1 We have no comments on this Principle.

Principle 2: Governance

Risk Committee

2.1 Paragraph 3.2.12 of the Principles states that *"An FMI should consider the case for a board risk committee, and a CCP, in particular is expected to have such a risk committee or its equivalent. A risk committee should be chaired by a sufficiently knowledgeable independent board member and consist of a majority of board members that are independent of management."* It is our understanding that, being a board committee, the risk committee described in this paragraph can only consist of independent and executive members of the board.

2.2 In this respect the obligation contained in this paragraph differs significantly from the obligation set out in art. 26 of EMIR, which requires a CCP to establish a risk committee *"composed of representatives of its clearing members and independent members of the board".* In this risk committee employees of the CCP (which in our view would include executive board members) cannot be members of the risk committee but may only be invited to the risk committee meetings in a non-voting capacity.

2.3 These very differing forms of the two texts would result in an obligation for European CCPs to maintain two different risk committees. Taking into account that one committee would be a board committee and the other an advisory committee (the advices of which however should in principle be followed and deviations explained to the supervisory authorities), this will in our opinion be detrimental to the quality and transparency of risk governance. Moreover CCPs that seek to provide services in other jurisdictions may be subject to differing requirements depending on local requirements[1].

2.4 In our opinion the requirements regarding the establishment of a risk committee should be consistent across the different regulations applying to CCPs. In order to enable a focused discussion on risk topics between the responsible board members and the risk experts of the participants, we have a preference for one single risk committee (or possibly one committee per asset class) which can consist of both independent and executive board members and risk experts.

2.5 In our opinion risk experts employed by the participants must participate in a personal capacity on the basis of their risk management knowledge and experience in the markets in

[1] See for example the rules proposed by the US CFTC at http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-26220a.pdf allowing a "Risk Management Subcommittee" and the US SEC at http://www.gpo.gov/fdsys/pkg/FR-2010-10-26/pdf/2010-26315.pdf and http://www.gpo.gov/fdsys/pkg/FR-2011-03-16/pdf/2011-5182.pdf

order to support the CCP in achieving an optimal risk management framework, and not as representatives of the participants, potentially defending the participants' interests which may in some cases be opposed to those of the CCP.

Principle 3: Framework for the comprehensive management of risks

Responsibilities in relation to members and clients

3.1 Key Consideration 2 of this principle requires that *"An FMI should provide incentives and, where relevant, the capacity to participants and their customers to manage and contain their risks."*

3.2 We fully understand the benefit of a CCP providing incentives to its participants to manage and contain their risk, and we support the principle that a CCP should put the appropriate incentives in place. However, the Principles are too far-reaching when they require CCPs to provide their participants (clearing members) and the customers of their participants with the "capacity" to manage their risks. In our opinion the word "capacity" could be understood to mean as not only reports containing information about positions, exposures and margin requirements, but also as tools, systems or even resources. In our view this not only puts too high a burden on CCPs but it also neglects the responsibility of clearing members and their clients to implement and run their own risk management. This would put a responsibility on CCPs which they cannot reasonably be expected to support and would make them liable for the risk management which should be performed by the clearing members. We therefore recommend replacing "*the capacity to participants (...) to manage and contain their risks."* by *"<u>the information (as specified in the rules and procedures of the FMI) to participants (...) to manage and contain their risks</u>."*

3.3 In addition, we note that the requirement that CCPs provide incentives and the capacity for appropriate risk management extends to the customers of participants. This seems to assume the existence of a legal relationship between the CCPs and their participants' customers. In fact, as already stated above under General Comments, most European CCPs generally work on the legal basis of a principal-to-principal relationship with their participants, which excludes any legal relationship with their participants' customers. Consequently we propose that "*and their customers*" is removed from Key Consideration 2.

Principle 4: Credit risk

Potential exposures

4.1 Key Consideration 4 states that *"A CCP should cover its current and potential future exposures to each participant fully with a high degree of confidence using margin and other financial resources (see principle 6 on margin which specifies 99 percent initial margin coverage and other requirements)".* In addition, on page 139 of the Consultation document, a definition is provided of potential future exposure: *"Any potential credit exposure that an FMI could face at a future date (such as the additional exposure that an FMI might potentially assume during the life of a contract or set of contracts beyond the current replacement cost*)". In fact, what is referred to here as "**potential future exposure"** is the potential liquidation cost which exceeds the current replacement cost. In our opinion therefore the term "**potential future replacement cost**" ("PFRC") is more suitable for this purpose and we therefore recommend using this term, defined as "The future cost that an FMI might potentially incur in liquidating contracts following the failure of a participant".

4.2 The common approach among CCPs is for margins (and not other financial resources) to cover potential future exposures with a high degree of confidence under normal market conditions, and other resources (default funds, assessment powers) to cover potential future exposures under extreme but plausible conditions, at least covering the largest member positions, for a given liquidation period. We suggest therefore that the Principles distinguish between $PFRC_N$ and $PFRC_{E,}$ (where N = normal and E = extreme), and that margins should cover $PFRC_N$ to a high degree of confidence, while additional financial resources be available to cover the largest $PFRC_E$ for a given number of members, subject to resolution of the cover 1 or cover 2 question.

Backtesting

4.3 Key Consideration 5 addresses the topics of backtesting and stress testing. Performing regular backtesting is a key tool to verify if the margin algorithm used by the CCP continues to provide the level of coverage which it is expected to provide. This is done by comparing the theoretical loss which would have been made on participants' portfolios (taking into account the actual price movements and the assumed liquidation period) with the initial margin held by the CCP to cover those portfolios. In order to arrive at a statistically relevant conclusion about whether the margin calculation remains in line with the prescribed confidence interval, backtesting should be performed over a long period, for example 12 months. During this period, the actual daily variations in the value of participants' portfolios will be compared to the corresponding initial margin amounts.

4.4 On page 137 of the Consultation document the following definition is given of backtesting: *"Backtesting involves comparing observed outcomes derived by a model (using actual historical data, that is, what actually occurred) against forecasted outcomes."* We would like to point out here that – as mentioned in the previous paragraph – the observed outcomes are not derived by a model, but are the actual value variations historically observed on the positions; it is the forecasted outcomes which are derived by using a model. We therefore propose that the definition is amended as follows: *"Backtesting involves comparing observed outcomes ~~derived by a model~~ (using actual historical data, that is, what actually occurred) against forecast~~ed~~ outcomes derived by a model."*

4.5 Considering the long history taken into account and the resulting large number of observations, the result of the backtesting should not be expected to change significantly from one day to another unless in the case of a significant market crash. Taking this into account, we assume that, when Key Consideration 5 refers to a daily backtest, the intention is that CCPs should perform a daily calculation of actual changes in the values of participants' portfolios. On the basis of these value changes, the CCPs' actual statistical analysis will then be made on, for example, a monthly basis.

4.6 It is the objective of initial margin to cover the losses resulting from a participant's default within a pre-defined confidence interval. It is the objective of backtesting to verify whether the initial margin calculated and collected has actually provided this pre-defined level of confidence over the period considered in the backtest. However, since the exposure of the CCP is to the defaulter's overall portfolio (and as a consequence the potential losses on that portfolio), back testing should in our opinion be performed on a participant level and not on the level of the individual product or spread.

4.7 Moreover, the reference to a single-tailed confidence interval fails to take into account that a CCP is exposed to both downside and upside risk. In our opinion a single-tailed confidence interval would not be correct when applied to a single product or spread, since the CCP cannot know ex ante whether it will be long or short in the product following the failure of a participant, and therefore whether its risk will be to an increase or a decrease in the price. It would not be practical to levy different margin requirements on positions depending on their direction.

4.8 In addition we consider that there is some ambiguity in the phrase that *"Initial margin should meet an established single-tailed confidence interval (...)* ***for each clearing member's portfolio****".* This sentence could be read to mean that the confidence level should be met for each individual member and for each individual portfolio within the member's account, whereas the adequacy of initial margin should be established across each clearing member's total portfolios to test the statistical relevance of the model in general.

Stress testing

4.9 As regards stress testing, we fully support the need for CCPs to apply an extensive range of stress tests including both historically observed and theoretically plausible extreme scenarios with the aim of establishing the level of financial resources the CCP requires in order to survive extreme but plausible market conditions. However it is not clear to us what the objective of a "reverse stress test" would be since such a test could, by definition (i.e. identifying extreme market conditions for which the CCP's financial resources would be insufficient), not be used to establish whether financial resources are adequate or not. Such tests would be extremely challenging to define given the multitude of variables applicable in the various markets served by CCPs.

4.10 Currently several regulatory initiatives pertaining to CCPs are being prepared or have come into force: CPSS-IOSCO Principles, EMIR and the Dodd-Frank Act. Since many CCPs will have to comply with several of these regulations, it is extremely important that all the requirements which they have to fulfil according to the different regulations are consistent and certainly not contradictory in any respect.

4.11 EACH strongly urges the promulgation of rules and Principles that ensure consistency and a level playing field between jurisdictions. EACH points out that the impression of safety given by a specific number of assumed failures must be qualified with reference to the severity of the stress scenarios in which the participants with the largest, or the two largest, exposures default, and the shortage between the failed members' initial margin and the losses in those scenarios that the CCP has to cover with the Default Fund and other financial resources. So it is in the setting of requirements on margin levels and the definition of stress tests that the emphasis should lie, rather than relying on the coverage of a specific number of defaults. In this context EACH also supports the various references that state that specific requirements can be tailored to the specific characteristics of the products and other considerations, as CCPs must also be concerned about efficiency.

4.12 Most EACH members seek that CPSS-IOSCO, EMIR and the US agency rules coalesce on the existing "cover one" rule (including affiliates) which proved adequate in the recent crisis, and are concerned by the various passages in the report which appear to indicate a preference for cover two (e.g. in paragraph 3.4.16), which would give rise to significant and (in the view of these members) disproportionate costs for CCPs and therefore for the markets. A minority of members however do recommend that CPSS-IOSCO agree on a "cover two" principle, chiefly because this would be consistent with the current provisions of EMIR and the US rulemaking which proposes a "cover two" principle for systemically-important Derivatives Clearing Organisations (DCOs) (noting that in paragraph 1.20 CPSS-IOSCO states that *"The presumption is that all ... CCPs ... are systemically important because of their critical roles in the markets they serve."*)

4.13 Paragraph 3.4.13 contains the following sentence: *"In addition, a CCP should stress test its initial margin requirements (...) to ensure coverage of potential future exposure with a high degree of confidence."* In our view this sentence provides an incorrect view of the relationship between initial margin and stress testing. Margin and stress testing both have their own role in the risk management framework of a CCP but one cannot be used to test the other. Margin is calculated with the objective of establishing the level of risk on a position under normal market circumstances, i.e. within a pre-defined confidence interval. Stress testing is performed in order to estimate the potential loss on that same position under extreme but plausible stress scenarios with the aim of establishing which amount of potential stress loss should be covered over and above the margin available. In practice this potential stress loss will be covered by a default fund or other financial resources in addition to the initial margin. Margin and stress testing therefore both cover different levels of risk and should result in complementary risk buffers.

Principle 5: Collateral

Acceptable collateral

5.1 Paragraph 3.5.2, together with footnote 44, contains restrictions on the use of collateral which some members of EACH believe are not appropriate for certain markets. For example, letters of credit have an important role in certain markets with large non-financial players.

Wrong-way risk

5.2 Paragraph 3.5.2 states that "*An FMI should avoid wrong-way risk by not accepting collateral that would likely lose value in the event that the participant posting the collateral defaults*". We acknowledge the importance for a CCP to identify and manage the wrong way-risk on collateral which would likely lose a significant part of its value in the event of the default of the participant posting the collateral. However, we consider the current wording to be too general and the required solution to be too strict.

5.3 As an example, in case of the default of a participant which is a large bank, it could be considered likely that the government bonds issued by the country in which the large bank resides would lose value. As a consequence, on the basis of this provision the CCP should not allow for a participant to post collateral in the form of government bonds of the country in which the participant is located. This argument can be extended to the currency of that same country in case of cash collateral.

5.4 We consider this to be an undesirable consequence. We therefore propose to change this requirement such that it should not prohibit the CCP from accepting collateral with a possible wrong-way risk, but to oblige the CCP to closely monitor for wrong-way risk and to require it to implement procedures for managing the wrong-way risk on collateral. It is worth pointing out that the judicious use of conservative haircuts, and the regular review of these haircuts, is an important control in this regard.

Valuation of collateral

5.5 Paragraph 3.5.3 states that *"An FMI should mark its collateral to market daily, at a minimum."* We agree that collateral should be marked to market on a daily basis. For the sake of clarity, we want to stress that we consider that, given that CCPs apply prudent haircuts, intraday revaluation of collateral is likely to be redundant.

5.6 In the same paragraph it is mentioned that *"an FMI should have the authority to exercise discretion in valuing assets according to predefined and transparent methods".* In our opinion there could be an inherent contradiction here between CCPs' authority to exercise discretion on the one hand and the application of predefined methods on the other hand; either pre-defined methods are implemented or discretion is allowed. We assume that what is intended is that there be pre-defined frameworks within which the FMI can exercise its discretion.

Concentration limits

5.7 The last sentence of paragraph 3.5.4. states: *"Further, concentration limits and charges should be constructed to prevent participants covering a large share of their exposures with the most risky assets acceptable.".* We query the need for this provision since assets' price risk is incorporated in collateral haircuts and in the global concentration limits proposed in the previous sentences. The purpose of these two tools is to homogenise the risk assumed by the CCP respecting all types of assets accepted as collateral.

Procyclicality

5.8 EACH agrees with the statements on procyclicality in paragraph 3.5.5. However we wouild like to point out that adjustments to a CCP's margins or haircuts need not of themselves give rise to adverse procyclical effects. As the CPSS noted in its report on "Strengthening repo clearing and settlement arrangements"[2] – and the principle applies to any market – "*An unanticipated substantial increase in its margins or haircuts, or a tightening of a CCP's collateral eligibility criteria could reduce liquidity in repo markets ... Sudden increases in haircuts and margins could reduce liquidity in repo markets, particularly if there is insufficient transparency on the practices and rules for revising or adjusting haircuts and margins.*" It is the fact that the increase may be sudden and unanticipated that may exacerbate an already stressed environment, and such effects can be mitigated if the CCP can indicate potential situations in advance where it is likely to impose an increase in margin requirements (or haircuts on collateral), while reserving the right to take any emergency action as necessary.

Principle 6: Margin

Margin coverage

6.1 According to Key Consideration 1 "*A CCP should establish margin levels (...) taking into account potential increases in liquidation times in stressed markets.*" This wording appears to deviate from the principle that initial margin is intended to cover liquidation risk under normal market conditions whereas separate, additional financial resources such as the default fund cover liquidation risk under extreme but plausible market conditions, i.e. in case of stressed markets. We are of the opinion that the clear distinction between initial margin and default fund which exists currently, and which is commonly understood and accepted by CCPs and their participants, should be maintained. Therefore we recommend removing the reference to the potential increases in liquidation times in stressed markets from this consideration.

Intraday calls

6.2 Key Consideration 4 states that *"A CCP should have the authority and operational capacity to make intraday calls for initial and variation margin from participants with positions that have lost significant value."* This sentence reads as though there must be a significant loss on the position before a CCP can issue a margin call. In our view it should also be possible for a CCP to call margin intraday if the potential future exposure increases substantially during the day. We therefore propose to change the sentence as follows: *"<u>A CCP should have the authority and operational capacity to make intraday calls for initial and variation margin from participants</u> ~~with positions that have lost significant value~~."*

Relationship between margin, stress-testing, and backtesting

6.3 Key consideration 6 refers to the fact that *"A CCP should analyse and monitor its (...) overall margin coverage by (...) stress testing".* Margin and stress testing both have their own role in the risk management framework of a CCP and they are not related in the sense that one

[2] http://www.bis.org/publ/cpss91.pdf

can be used to test the other. Margin is calculated with the objective of establishing the level of risk on a position under normal market circumstances, i.e. within a pre-defined confidence interval. Stress testing is performed in order to estimate the potential loss on that same position under extreme but plausible stress scenarios with the aim of establishing which amount of potential stress loss should be covered over and above the margin available. In practice this potential stress loss will be covered by a default fund or other financial resources in addition to the initial margin. Margin and stress testing therefore both cover different levels of risk and should result in complementary risk buffers. Stress testing cannot be used to analyse and monitor margin coverage and we recommend that this key consideration is be amended accordingly.

6.4 Paragraph 3.6.7 regarding the close-out period for initial margin states with regards to the historical data used to estimate a CCP's close-out period that this *"should include the worst events that occurred in the selected time period (...) as well as simulated data projections that would capture potential events outside of the historical data."* While any extreme events that occurred within the selected timeframe will of course be included, the inclusion of simulated data projections describes the conditions for the data to be used for determining stress scenarios rather than the data required for a margin calculation, and follows our earlier suggestion that the Principles separate the definition of potential future exposures using PFE_N and PFE_E, with the former to be covered by initial margin.

6.5 Two further possible interpretations of the suggestion to "*include the worst events that occurred*" in the initial margin price history are a) that the extreme price movements experienced, going back over the complete history of the cleared contract, should be added to the price history, or b) that the price history should extend far enough back to include such movements, and including all the history in between. In our view, the former alternative should already be covered by CCPs' stress scenarios derived from actual historical events to cover PFE_E, while the latter would not necessarily increase margin coverage as their impact would be diluted by the greatly increased number of price observations in conjunction with the confidence interval.

6.6 Paragraphs 3.6.14 and 3.6.15 describe both stress testing and back testing under the heading "*Testing margin coverage*". We agree that back testing is the right tool to test the adequacy of margin coverage. However, as argued above in our comment to Key Consideration 6, stress testing should be considered as a separate risk management calculation which is not intended to test the adequacy of initial margin, but to estimate different risks from those covered by the initial margin calculation. We therefore recommend separating back testing and stress testing under different headings.

6.7 According to paragraph 3.6.15 *"stress tests should be performed on both actual and simulated positions."* Considering the fact that stress testing is intended to estimate the risk actually run by the CCP on its participants under extreme but plausible market conditions in order to establish the financial buffers required to adequately cover that risk, there is no place for performing stress tests on simulated positions, which, if different, would by definition be implausible.

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Principle 7: Liquidity Risk

Ensuring settlement

7.1 According to Key Consideration 3 *"An FMI should maintain sufficient liquid resources (...) to effect same-day and, where appropriate, intraday settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the [one/two] participant[s] (...)."* We support the requirement of timely settlement but note that it appears to contradict the statement in the EU Bank Resolution paper[3] which outlines that there should be a moratorium on settlements in the period immediately after a participant has been declared in default – a proposal to which EACH has strongly objected to. In addition, it should be noted that bank settlement systems may not offer more than one settlement process per day, or real-time settlement.

Source of liquidity needs

7.2 In addition, Key Consideration 3 states that *"A CCP should have sufficient liquid resources to meet required margin payments and effect the same-day close out or hedging (...)."* We would like to highlight that the most important flow of cash can be related to the settlement obligations of the defaulter, which is not mentioned in this sentence. Moreover, when the sentence refers to margin payments, we assume that this means the payment of variation margin since the CCP does not post initial margin to its members. We recommend adjusting this sentence in order to clarify more precisely the types of flows which give rise to the need for a CCP to have liquidity facilities.

7.3 Furthermore, we recommend the deletion of the requirement for same day close-out or hedging as it directly contradicts requirements elsewhere in the recommendation such as in 3.13.1: (c) limiting disruptions to the market; (e) managing and closing out the defaulting participant's positions and liquidating any applicable collateral in a prudent and orderly manner.

Required coverage

7.4 Regarding the default liquidity risk, there are different views within EACH, reflecting differing views of the required coverage. The majority of EACH members agree that the same principle of assessing members' affiliates in determining the effects of the "cover one" or "cover two" scenarios is correct, and most believe that, subject to the comments under Credit Risk above, the same level should apply both for default waterfall and liquidity adequacy. Most EACH members therefore are of the opinion that a CCP should maintain access to sufficient liquid resources to cover the single largest liquidity exposure it has in respect of one participant, while a minority believes that coverage of two participants is the better solution.

7.5 However there is also a view that there is a number of differences between market risk and liquidity risk, and that "cover two" for credit risk and "cover one" for liquidity risk should be the correct approach. First of all, market risk buffers (margin, default fund) must cover losses

[3] http://ec.europa.eu/internal_market/consultations/docs/2011/crisis_management/consultation_paper_en.pdf

resulting from liquidation. Therefore these buffers can be used only once during the default management process. Liquidity buffers, to the contrary, are "self replenishing" in the sense that they are used in the settlement process and freed up again in the liquidation process. A scenario determining the liquidity need by assuming the default of the clearing members posing the two largest liquidity requirements would therefore also have to assume that these defaults take place at exactly the same time and result in liquidity needs at exactly the same time. As mentioned above, this is different for market risk since margin and default fund contributions can be used only once to cover the loss. The possibility of an exactly simultaneous second failure giving rise to an additional liquidity need is far less than the (already remote) possibility of a second failure requiring additional default resources before they have been replenished from the first default, some days earlier.

7.6 In addition it should be noted that liquidity requirements are related to the principal amounts traded rather than to a percentage of those amounts, as is the case for market risk buffers. Therefore adding up the liquidity requirements for the two participants to which the CCP has the highest liquidity exposure will result in extremely high theoretical liquidity requirements, specifically for those CCPs which clear bonds or cash equities. Ensuring the availability of liquidity for these amounts will be very costly, especially when it is done through some form of pre-arranged funding arrangement.

7.7 For these reasons a further minority of EACH members believes that CCPs should be required to cover two failures for credit risk but only one for liquidity risk.

Testing of access to funding

7.8 The last sentence of paragraph 3.7.10 states that *"An FMI should regularly test its access to these prearranged funding arrangements."* We assume that the scope of such a test would be limited to procedures and lines of communication; actual access to the liquidity (i.e. will the contractual partner actually provide the liquidity as agreed?) under extreme but plausible market conditions cannot be realistically tested.

Central bank credit

7.9 In paragraph 3.7.11 it is stated that *"With regard to emergency central bank credit, an FMI should not assume the availability of such credit as part of its liquidity plan. An FMI needs to have private-sector sources of emergency credit in place."* We would like to point out that this paragraph is not clear on where exactly the boundary lies between routine central bank credit and emergency central bank credit. We consider that an explicit definition of these two types of credit would be a useful addition to the text of the Principles.

7.10 Subject to that clarification being made, we understand that the intention of paragraph 3.7.11 is that where a CCP does have access to the provision of *routine* central bank credit on a collateralised basis, such access can be taken into account (alongside its access to commercial bank credit) in any assessment of the CCP's access to liquidity, whereas a CCP should not make any planning assumptions about the availability of *emergency* credit from a central bank.

Stress testing

7.11 Paragraph 3.7.14 contains reference to a host of stress tests, some of which should be performed "*at least monthly*", others "*daily or weekly*" and others "*annually*". We would like to highlight that the current wording does not sufficiently clarify how frequently (daily, weekly, monthly or annual) each type of stress test should be performed. We would like to propose an alternative approach which makes a distinction between the regular stress scenarios which must be run on a frequent basis (e.g. daily or weekly) and the review of the assumptions and approach underlying those stress scenarios, which should be reviewed on an annual basis.

Replenishment

7.12 Paragraph 3.7.16 refers to the replenishment of liquid resources. It is not clear from the text what is exactly meant by this phrase. It could be argued that replenishment of liquid resources happens automatically since by their very nature the liquid resources will be returned in the course of the liquidation process. We recommend that the intention of this concept is further clarified in the text.

Principle 8: Settlement finality

Legal framework

8.1 In paragraph 3.8.2 it is stated that *"The legal regime governing the FMI, including the insolvency law, must acknowledge the discharge of a payment, transfer instruction, or other obligation between the FMI and system participants".* We do not understand the reason for the inclusion of this sentence in the Principles since this is the responsibility of the legislator and cannot be changed by the CCP.

Fails

8.2 Paragraph 3.8.3 states that *"An FMI that does not provide final settlement on the value date (or same-day settlement) would not satisfy this principle even if the settlement date of the transaction is adjusted back to the value date after settlement."* We would like to point out that this sentence appears to prohibit the occurrence of settlement fails which is not consistent with other parts of this document which discuss the implication of (permissible) fails. This also raises the question of what are the regulatory consequences for a CCP if a fail occurs.

Principle 9: Money Settlements

Assets

9.1 Key consideration 2 refers to the use of *"a settlement asset with little or no credit or liquidity risk".* Given the context we interpret it as a reference to a settlement agent rather than a settlement asset, or possibly a private settlement system, and this should be clarified.

Principle 10: Physical delivery

10.1 We have no comments on this Principle.

Principle 11: Central securities depositories

11.1 We have no comments on this Principle, which does not apply to CCPs.

Principle 12: Exchange-of-value settlement systems

12.1 According to the table in Annex D this principle is applicable to CCPs. However, we do not observe any paragraph under this Principle which we consider to be relevant for CCPs. Therefore we request for more clarification in the text as to why and to which extent this Principle could be applicable to CCPs.

Principle 13: Participant-default rules and procedures

13.1 Paragraph 3.13.1 provides a list of key objectives of default rules and procedures: *"(a) ensuring timely completion of settlement even in extreme but plausible market conditions; (b) minimising further losses at the FMI, other participants and the customers of the defaulting participant; (c) limiting disruptions to the market; (d) providing a clear framework for accessing FMI liquidity facilities as needed; (e) managing and closing out the defaulting participant's positions and liquidating any applicable collateral in a prudent and orderly manner."*

13.2 In our view it is not entirely clear how this list of objectives, and especially objective (a) regarding timely completion of settlement, relates to the text of 3.13.2 which states that the CCP should describe in its rules and procedures the changes to normal settlement practices in case of a participant default. As a matter of fact:

- **3.13.2 (c)** foresees "*changes to normal settlement practices*"
- **3.13.1 (a)** aims at "*ensuring timely completion of settlement even in extreme but plausible market conditions*"
- **3.8.3** states that "*an FMI that does not provide final settlement on the value date would not satisfy this principle*…"

13.3 In this context we would like to stress that we are of the opinion that, whereas the objective of the CCP should be to ensure timely settlement in case of the default of a participant, it should also be able to make changes to the normal settlement process if such changes would be required to mitigate market risk exposure or liquidity pressure following the default. If this is the intention of the text it would be helpful if this would be made more explicit.

13.4 In addition, it is not clear to us how *"providing a clear framework for accessing FMI liquidity facilities as needed"* as mentioned in 3.13.1 as objective (d) could be an objective of default management for a CCP. Within the context of a participant default, the CCP must have access to liquidity facilities but such facilities are tools for the CCP rather than an objective. The question therefore arises whether this objective pertains to CCPs or not and if it does what is the exact intention of the objective. It would be helpful if this would be clarified in the text of the Principles.

13.5 The lists in 3.13.2 (rules and procedures, to be made public as per 3.23.2) and in 3.13.6 ("*public disclosure*", therefore public) could be better harmonised (NB the items are paraphrased and are not reported verbatim):

3.13.2	3.13.6
Automatic or decision?	a) triggering circumstances
a) actions that can be taken	b) decision taker
b) actions are automatic or discretionary?	c) scope of action, in particular for clients' assets and positions
c) changes to normal settlement practices	d) obligations towards non defaulters
d) management of transactions at different stages of processing	e) the mechanism to address defaulter's obligations to its customers
e) expected treatment of client and house positions and assets	
f) likely sequence of actions	
g) roles, obligations and responsibility of stakeholders	
h) other (if any) default impact-mitigating mechanisms	

13.6 Paragraph 3.13.3 refers to collateral and margin posted by the defaulting participant as the assets to be used first to cover the losses resulting from the default. In our view this choice of words is confusing. The word "margin" can be eliminated here since all collateral provided by the defaulter should be used before any collateral provided by the surviving clearing members is used. The defaulting participant's collateral may have been provided to cover margin requirements, default fund contribution or may even be excess collateral. We therefore recommend adjusting the sentence accordingly.

13.7 Furthermore we would like to point out that there could be a potential conflict of this requirement with the requirement to segregate clients collateral, which would (although indirectly) be clearing member assets. It should be made clear that segregated client collateral does not count as the defaulting participant's assets. We understand that those assets should not at all be used to cover losses resulting from the default of a clearing member, apart from in the case of a potential close out of the positions of the segregated client(s).

13.8 Paragraph 3.13.4 states among other that *"It is critical that a CCP has the authority to act promptly in the manner it thinks is best to contain its exposure (...)".* We fully support this statement. Given the central role of a CCP in the market it is indeed essential that a CCP has sufficient discretion to contain its exposure and protect itself from the risk of excessive losses on the position it must manage following a default. Such losses could endanger not only the solvency of the CCP itself, but could have more far-reaching systemic effects. We would like to raise the question, however, how this authority relates to what is stated in paragraph 3.13.5 which states that the CCP should *"indicate the circumstances when management can exercise discretion"* in its rules and procedures. We would like to highlight that we consider that it is impossible to envisage up front all possible events which could occur and which could potentially lead to circumstances in which the CCP would want to (or need to) have the authority to exercise discretion. Any indication of circumstances in which the CCP can exercise discretion must therefore be made on a "without limitation" basis. We recommend making this point explicit in paragraph 3.13.5.

Principle 14: Segregation and portability

14.1 We notice that the text of this Principle refers to "customer positions and collateral", "collateral belonging to customers of a participant" and "customer collateral and positions". We would like to highlight that this choice of words gives the impression that the collateral has been deposited by the customer at the CCP, whereas in practice the collateral is deposited at the CCP by the clearing member in the name of the client. This collateral deposited at the CCP is not necessarily the same collateral which has been deposited by the customer at the clearing member. The clearing member may have – and in many cases; will have – deposited different collateral at the CCP representing the same or similar value (depending on the specific margin requirement) as the collateral deposited by the customer at the clearing member. As a consequence the CCP will not be able to transfer the customer's collateral to another clearing member but might be able to transfer collateral deposited by the clearing member in respect of customer positions.

14.2 In our opinion the current Principle 14, and especially Key Consideration 1 of this Principle, could be read as an obligation for the CCP to segregate customers' positions and collateral to the fullest extent possible under applicable law; *"A CCP should have segregation and portability arrangements that protect customer positions and collateral to the greatest extent possible under applicable law".* This is inconsistent with the Explanatory Note contained in paragraph 3.14.10 which states that "*The CCP should maintain collateral supporting customer positions in an omnibus account or in individual accounts at the CCP or its custodian. A CCP should consider offering individual customer account segregation given the additional protection benefits. In considering whether or not to offer individual customer accounts, the CCP should take into account all relevant circumstances."* As such, we recommend that Key Consideration 1 should be redrafted to say that "*<u>A CCP should have segregation and portability arrangements that protect customer positions and related collateral – particularly in the event of the default or insolvency of a participant – subject to the constraints of applicable law."</u>*

14.3 It should be noted that there are many different types of customers. The text of the Principle does not make a clear distinction between types of customer nor does it specify to which types of customer this Principle pertains. For example, the participant of a CCP – the clearing member – may have as its customers: trading member firms (trading either for own account, for clients or both), buy side firms, or even retail clients. It is currently unclear from the text which types of customer could apply for full segregation. We recommend further specificity and clarification of this in the text.

14.4 In this respect we would also like to point out that the larger the scope of the types of customers covered by this Principle, the less efficient the system will become (cost of gross collateral, system cost, clearing member fees) and the more complicated and time consuming the default management process will become – which in turn would have to be reflected in the close-out period taken into account in the CCP's margin calculation. However, a model with segregated client accounts implies that the CCP holds a broader collateral base, and to the extent that this increases the safety of the CCP itself should ensure that exposures to the CCP are given a preferential capital treatment.

14.5 Footnote 95 on page 69 repeats what is already stated in paragraph 3.14.9. In our opinion this footnote could be removed.

14.6 In our opinion, the last sentence of paragraph 3.14.10 "*In addition, assets held by the participant should be limited to any excess collateral posted by the customer beyond that which is required by the CCP to cover its exposures*" does not contain a requirement for the CCP since this only regards the relationship between the participant and its client. As such, we consider that this sentence does not provide any added value in the context of this paper.

Principle 15: General business risk

15.1 As regards the capital requirement, we take the assumption that the CCP should be able to cover its costs over a period required to close out or transfer any positions it may have in its books. On this assumption, equity capital of 6 months' expenses provides more than adequate cover for such an orderly wind-down.

Principle 16: Custody and investment risk

16.1 We have no comments on this Principle.

Principle 17: Operational risk

17.1 Paragraph 3.17.4 states: *"an FMI should comply with, or, depending on the FMI's importance and level of interconnectedness, exceed the relevant industry's best practices."* Whereas we understand that an FMI should aim to comply with best practices, we have difficulty in understanding a requirement to exceed best practices.

Principle 18: Access and participation requirements

18.1 Key Consideration 1 states that "*An FMI should allow for fair and open access to its services, including by direct and, where relevant, indirect participants (...)".* We would like to highlight that CCPs, which operate on a principal-to-principal basis with their clearing members have no authority over the access of indirect participants. This access is dependent on clearing members' acceptance criteria and is managed between the clearing member and its (potential) clients.

18.2 The last sentence of Paragraph 3.18.2 states that "*An FMI's participation requirements should therefore encourage broad access, including access by participants, other market infrastructures (...)".* There is a similar statement in Key Consideration 1. In their current form these references would require a CCP to encourage access from other market infrastructures, including its competitors. As a matter of principle, we do not believe it is appropriate for CPSS-IOSCO to establish requirements which are, strictly speaking, matters for competition policy. We therefore recommend that Principle 18 should be focussed on access and participation requirements for clearing members, leaving competition matters to the relevant competition authorities.

Principle 19: Tiered participation arrangements

19.1 As stated in the explanatory note in paragraph 3.19.1 this Principle *"encourages FMIs to identify, understand, and manage their risks arising from tiered participation arrangements, recognizing that the ability of a particular FMI to identify, understand and manage all such risks is likely to be limited."*

19.2 The limited ability of CCPs to manage the risk resulting from the clients of their clearing members is also reflected in other parts of the text of the Principle when wording is used such as "*to the extent practicable*", "*to the extent possible*", "*there are limits to the extent to which an FMI can...*", "*an FMI may face legal or practical constraints*" etc. Taking into account all these caveats in the text, it is difficult to understand how a CCP can be objectively assessed against this Principle.

19.3 However, in our opinion the many constraints and limitations mentioned in the text are completely valid. As mentioned under General Comments, most CCPs work under the principal-to-principal model which excludes any legal relationship with the clients of their clearing members and which will make it very difficult, if not impossible, for the CCPs to enforce any risk mitigation actions which might be required vis-à-vis these clients. The responsibility for managing this client risk should therefore lie in the first place with the clearing member since it is the role of the clearing member to manage this risk.

19.4 Moreover, the CCP (and even the clearing member) may see only a small part of the total exposure the client has in the different products and markets, especially when the client is a bank or large trading firm. The only institution which should have a total overview of the exposures of the client, as well as the risks run and the capital available to cover those risks, is the home country regulator of this client. In our opinion, the home-country regulator is therefore the right institution to control any concentrations of risk which might be posed by the client.

19.5 Finally, it should be mentioned that performing risk management activities on clients of clearing members will require a significant increase in resources (and possibly systems) and therefore cost, for CCPs. Given the limited added value which can be expected from this it seems neither efficient nor effective to require CCPs to perform this role.

Principle 20: FMI Links

20.1 Paragraph 3.20.1 states that "*A CCP may establish a link with another CCP to enable a participant in the first CCP to clear trades with a participant in the second CCP through the participant's existing relationship with the first CCP."* It should be noted that this ability depends on both CCPs having access to the same trading venue.

20.2 EACH does not agree with the statement made in paragraph 3.20.13 that *"Another source of risk may emerge if a link arrangement treats the linked CCP differently from other participants, such as setting less strenuous participation requirements for the linked CCP than for other participants."* In our view the risk on the position resulting from a link should be managed in accordance with the risk profile and function of the CCP. Other risks will not emerge from the fact that a linked CCP is treated differently from other participants; additional risk may emerge if the linked CCP is not risk managed in accordance with its risk profile and function, but this statement could be made in relation to all the participants of a CCP.

20.3 Paragraph 3.20.14 discusses the contagion risks resulting from CCPs contributing to each other's default funds and concludes that *"Typically, CCPs should not contribute to each other's default fund."* We fully support the argumentation and the concluding statement. However, we do not understand why the paragraph then goes on to state that *"Further they should maintain risk management arrangements which may involve a separate default fund to cover risk from a link."* Without further clarity, this sentence is a non sequitur in relation to the argument made just before and moreover, it gives an example of sorts rather than a requirement. We propose that it is removed so that this paragraph ends with the clear conclusion.

20.4 In Paragraph 3.20.16 the sentence: "*The CCP that provides an account to another linked CCP may therefore need to hold additional financial resources to protect itself against the default of the linked CCP*" does not appear correct. As indicated a few lines above "…*the CCP that maintains an account for another CCP would typically require the other CCP to provide margin*…" therefore is the acceding CCP that has un-collateralised exposure vis-à-vis the accessed CCP (i.e. the CCP that provides/maintain an account to/for another CCP). In general, in the whole paragraph there is room for improvement in terms of clarity.

Principle 21: Efficiency and effectiveness

21.1 We have some concerns about the wording of the following sentence from Paragraph 3.21.3: *"For example, an FMI may need to consider its participants' liquidity costs, which include the amount of cash or other financial instruments a participant must hold with the FMI or other parties in order to process its transactions and the opportunity cost of holding such assets."*

21.2 Our concern with this text is that it appears to require CCPs to consider the amount of collateral they require from their participants from a liquidity cost point of view. In our opinion risk mitigation should always prevail over cost considerations. We therefore propose to add to this paragraph a sentence that states that the actions resulting from this consideration should never be detrimental to the risk management of the CCP.

Principle 22: Communications procedures and standards

22.1 We do not agree with the statement in 3.22.3 that the use of internationally accepted standards for message formats is "*an important precondition for interoperability and the introduction of STP.*" While EACH supports the development and use of standards, STP and interoperability depends only upon the adoption by relevant parties of agreed, rather than universal, standards,

Principle 23: Disclosure of rules and key procedures

23.1 While we accept the principle in 3.23.1 that "*an FMI should adopt and disclose written rules and procedures that are clear and comprehensive and that include explanatory material written in plain language so that participants fully understand the system's design and operations, their rights and obligations, and the risks of from participating in the system"* as a goal, it will not be possible to for a CCP to ensure that participants do in all cases always understand all of these issues, and this should be recognised.

23.2 We note that Paragraph 3.23.5 is neither applicable from a safety nor an efficiency point of view and therefore question whether it should be included in these Principles.

23.3 On the basis of Paragraph 3.23.6 CCPs are required to provide to their participants *"the details of stress tests and other data to help participants understand and manage their potential financial risks from participation to the FMI."* We would like to highlight that, although information can be provided regarding the methodology of stress testing and the scenarios applied, due to reasons of confidentiality the results of stress tests on members' positions cannot be provided to other participants.

23.4 There is no indication of the language in which information has to be provided. We propose that the Principle should be amended to stipulate that at a minimum this should be in the local language(s) and a commonly used business language.

Principle 24: Disclosure of market data

24.1 We have no comments on this Principle, which does not apply to CCPs.

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