



**Eurex Clearing
Comments
to the**

**CPSS-IOSCO Consultative
Report**

**“Principles for Financial Market
Infrastructures”**

March 2011

Frankfurt am Main, 20.07.2011

A. Introduction

Eurex Clearing is a globally leading central counterparty clearinghouse (CCP) and the largest clearinghouse in Europe. Eurex Clearing is a subsidiary of Deutsche Börse Group providing central clearing services for cash and derivatives markets both for listed as well as certain over-the-counter (OTC) financial instruments. Eurex Clearing actively contributes to market safety and integrity with state-of-the-art market infrastructure both in trading and clearing services as well as with industry leading risk management services for the financial industry. Customers benefit from a high-quality, cost-efficient and comprehensive trading and clearing value chain.

Eurex Clearing AG is a company incorporated in Germany and licensed as a credit institution under supervision of the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) pursuant to the Banking Act (Gesetz für das Kreditwesen). The Financial Services Authority (FSA) has granted Eurex Clearing status as a Recognised Overseas Clearing House (ROCH) in the United Kingdom.

Eurex Clearing welcomes the opportunity to comment on the March 2011 consultative report "Principles for Financial Market Infrastructures" of the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO).

This comment paper is arranged as follows. The first section contains a summary of our key concerns on the CPSS-IOSCO consultation paper. The second section provides detailed comments on each proposed principle. In addition, this part includes responses to the specific questions raised by Committees of CPSS-IOSCO on principles 4 (credit), 7 (liquidity risk), 14 (segregation and portability), 15 (general business risk) and 18-20 (access and interoperability).

B. Comments

B 1: Summary of critical issues

Applicability of the new CPSS-IOSCO Principles

When finalized the new CPSS-IOSCO principles shall replace the following current standards:

- Core Principles for Systemically Important Payment Systems (2001)
- The Recommendations for Securities Settlement Systems (2001); and
- The Recommendations for Central Counterparties (2004)

We acknowledge the efforts by the Committees to provide a single set of standards aiming at consistency in the oversight and regulation of FMIs worldwide.

However, while reviewing the proposed CPSS-IOSCO principles we noted that the introduction of the term FMI and the broad scope creates in many cases significant uncertainty and ambiguity for which of the FMIs the principles apply.¹

¹ Examples:

- Principle 5, paragraph 3.5.7 on collateral management services
- Principle 7, paragraph 3.7.6 on an FMI using DNS mechanisms to be able to reduce its or its participants' liquidity risk by using alternative settlement designs. Is this or part of this paragraph applying to CCPs?
- Principle 7, paragraph 3.7.16 about contingency planning for uncovered liquidity shortfalls. Does this apply to CCPs or rather to settlement systems?

We trust that the Committees of CPSS and IOSCO address these issues in the final report and would like to mention the clear structure of principle 4 distinguishing between credit risk in payment systems, CSD, or SSS and credit risk in CCPs as well as principle 20 on FMI links as reference. We recommend structuring the applicability for each type of FMI in other principles in a similar way.

Consistency with Legislation

We note with great concern that on many occasions principles slightly or significantly deviate from current legislative proposals and rule making implementing the G20 recommendations to strengthen market integrity for the OTC derivatives markets. From a CCP perspective this relates first and foremost the European Market Infrastructure Regulation.

We would urge the Committees that the CPSS-IOSCO principles in their final version ensure maximum consistency with ongoing legislative and rule making proposals to avoid conflicts and double regulation for both regulators and FMIs.

In addition, the new CPSS-IOSCO principles are closely linked to the proposed treatment of bank exposures to CCPs under Basel III. Compliance with the CPSS-IOSCO principles is a key condition to be considered as "qualified CCP" under Basel III.

In that respect, the final report should provide a transparent assessment methodology for each of the FMIs individually to provide a clear guidance on how to achieve compliance.

Relationship of CCPs with direct and indirect participants

In the consultation document we noted additional requirements for FMIs to perform risk oversight on indirect participants.²

While we recognize and appreciate the regulators' objective to better protect indirect participants against the failure of their clearing members, this direct risk oversight by CCPs on indirect participants and clients of (direct) participants is neither practicable nor desirable. Most CCPs maintain a principle-to-principle relationship with their direct participants who act as risk intermediaries. Hence, the CCP has no relationship with indirect participants and clients and often does not know their identity. We would also like to highlight that CCPs have well-established legal relationship with their direct participants, while in most cases there is no legal relationship between the customer of a direct participant and the CCP.

A CCP should be responsible for managing its own risks and that of its direct participants, providing risk management services and information to enable its direct

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- Principle 8, in particular paragraph 3.8.3 about same day settlement, paragraph 3.8.4 and 3.8.5 about intraday settlement using batch settlements based on DNS mechanism and RTGS systems and paragraph 3.8.6 about revocation of transfer instructions
 - Principle 12 particularly paragraphs 3.12.2, 3.12.3 and 3.12.5.
 - Annex C: Selected RSSS market wide recommendation. Recommendation 4 on CCPs asks for an evaluation of benefits and costs of a CCP. Where such a mechanism is introduced, the CCP should rigorously control the risk it assumes. This indicates that Annex C also applies to CCPs.

² Principle 19

participants to manage their own risks and act as intermediaries for their clients. In addition, CCPs should provide risk management services and information to enable direct participants to monitor and manage the risk of their clients.

Scope of access and participation requirements

The consultation document requires broad access for other infrastructures and service providers beyond access for participants, indirect participants and other FMIs as defined in the CPSS-IOSCO consultation document, namely CCPs, CSDs, SSSs and TRs³. While access requirements for participants and FMIs are defined in the CPSS-IOSCO document, risk-based access requirements for "other market infrastructures and service providers" are not defined. Pushing interconnectivity among infrastructures substantially raises systemic risks and undermines market integrity. We also note that this principle is not in line with the legal framework for CCPs both in Europe and the United States. Access in the document should only refer to the ability to use CCPs services including the direct use of the CCPs' services by participants and indirect participants

We understand the objective of the CPSS-IOSCO consultation document as improving the safety and efficiency of FMIs and their relationship to their direct participants and where relevant indirect participants. Hence, we propose to delete the reference to FMIs and other market infrastructures and service providers to avoid adding systemic risk and eroding market integrity.

Liquidity risk buffers

We regard the requirements for liquidity risk buffers as excessively high, leading to significant cost burden for the FMI and its participants and to be in contradiction with the principle of efficiency. In contrast to the treatment of credit risks, where collateral to cover potential losses is frozen in the moment of a participant's default and can be used only once, liquidity requirements have to be assessed in a dynamic way since refinancing over the period of handling a default is possible. In addition, liquidity buffers can be used more than once. It is also important to note, that liquidity is only necessary to interim finance the liquidation of open positions. Liquidity buffers are not intended and used for loss absorption. Thus, for a conservative liquidity risk management we propose that the report limits the required liquid resources to be sufficient to cover the default of the one participant with the largest liquidity exposure.

If a CCP has access to collateralized central bank liquidity this should be considered as part of the liquidity plan.

³ Principles 18

B 2: Detailed comments

1.20 General applicability of the principles

As stated in paragraph 1.20 *"the principles in this report are broadly designed to apply to all systematically important payment systems, CDSs, SSSs, CCPs, and TRs. FMIs that are determined by national authorities to be systemically important are expected to meet these principles."*

Comment:

Eurex Clearing does not support a discretionary approach determining "systemically important" FMIs through national authorities. The report should state that "all payment systems, CDSs, SSSs, CCPs, and TRs (FMIs) are considered systemically important and are expected to meet these principles." The rationale is that the failure of an FMI, independent of size and scope, can trigger systemic disruptions. In addition, only an equal categorization of FMIs will provide a level playing field and avoid the opportunity for regulatory arbitrage.

Principle 1: Legal basis

Paragraph 3.1.5 of the Principles states *"that the claims of the FMI or its participants against collateral posted to the FMI by a participant should have priority over the claims of third-party creditors."*

Comment:

The meaning of that sentence is not clear to us. The claims that the FMI has against the participant must have priority over the claims of general creditors. Eurex Clearing recommends deleting the phrase "or its participants" to ensure more clarity.

Principle 2: Governance

Comment:

As a general comment to principle 2 we would like to highlight that paragraph 3.2.4 correctly describes the fact *"that there is no single set of governance arrangements that is appropriate for all FMIs and all market jurisdictions. [...] For example, national law may require an FMI to maintain a two-tier board system, in which the supervisory board (all non-executive directors) is separated from the management board (all executive directors)."* The intention of *"this principle is [...] to be generally applicable to all ownership and organizational structures."*

We support the intention of CPSS-IOSCO to cater for the multiple roles of a board, including related governance and other policies and procedures.

Unfortunately, the paragraphs 3.2.7, 3.2.8 and 3.2.9 focusing on the role and composition of the board of directors disregard the governance structure in a two-tier board system, leading to legal uncertainty or conflict with national law. As a solution to bring these diverging aims in line, we propose to explicitly leave it to the discretion of the FMI in coordination with national authority to assign which duties to one of their boards. The report should state that role and composition of the board as well as the applying governance and other policies and procedures can be different in a two-tier

structure. Nonetheless, the appropriateness of the arrangements shall be approved by the national authority in line with the aim of the CPSS-IOSCO principles.

As mentioned in key consideration 6 *"the board should ensure that the FMI's overall strategy, rules, and major decisions reflect appropriately the interests of its participants and other relevant stakeholders."*

Comment:

Eurex Clearing agrees that a board's decision-making process should consider the interests of all FMI's stakeholders equally. Subsequently, there is no need to distinguish between participants and other stakeholders. Stakeholders of a CCP comprise, amongst others, owners, clearing participants, regulatory authorities, indirect participants and other FMIs. Therefore, we propose to replace the phrase "of its participants and other relevant stakeholders" with "all stakeholders". This ensures neutrality of the FMI and avoids the misconception that participants have an outstanding role compared to the other stakeholders.

Paragraph 3.2.5 requires that *"an FMI that is part of a larger organization...should place particular emphasis on the clarity (including in relation to any conflicts of interest and outsourcing issues that may arise because of the parent or other affiliated organization's structure) and adequacy of its own governance arrangements..."* and *"Similarly, a for-profit entity may need to place particular emphasis on the independence of its risk-management arrangements to manage any conflicts between income generation and resilience."*

Comment:

Eurex Clearing wonders why certain ownership structures and organizational forms are treated more prominently than others. We propose that the report requires clear and adequate governance arrangements from FMIs regardless of ownership structures and organizational forms. It is our understanding that the CPSS-IOSCO principles address the safety and integrity of the FMIs on a non-discriminatory basis to achieve a level playing field.

In addition, for-profit entities have a strong self-interest to apply highest standards in their risk managements and increase the prudential standards while in other forms of FMIs, e.g. user-owned FMIs, this incentive might be less pronounced or subject to the influence of certain user groups. Hence, we propose to re-phrase the sentence "a for-profit entity may need to place particular emphasis on the independence of its risk-management arrangements to manage any conflicts between income generation and resilience." into "FMIs need to place particular emphasis on the independence of its risk-management arrangements to manage any potential conflicts of interest".

As outlined in paragraph 3.2.12. *"[...] The reporting lines for risk-management should be clear and separate from those for other operations of the FMI, and there should be an additional direct reporting line to a non-executive director on the board via a chief risk officer (or equivalent). 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."*

Comment:

Eurex Clearing would like the report to notice that a direct reporting line to a non-executive director on the board via a chief risk officer (or equivalent) is not possible in

a two-tier structure. A reporting line in a two-tier structure can only be to the executive board.

In addition, we noted a discrepancy between the requirements for a Risk Committee under EMIR⁴ and the proposed CPSS-ISCO consultation text. Paragraph 3.2.12 of CPSS-IOSCO requires a "board risk committee" whereas EMIR determines a risk committee with an advisory role to the board. To avoid any conflict of interest the risk committee should only have an advisory role to the (management) board. The report should be aligned with the current EMIR proposals requiring a risk committee with an advisory role to the board. This would ensure a consistent and aligned approach throughout the regulations. Otherwise two "risk committees" under two regulations might be necessary leading to high administrative burdens without adding any value.

Principle 3: Framework for the comprehensive management of risks

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."*

Comment:

Eurex Clearing in general supports appropriate incentives (including penalty schemes) as useful measures to manage the risks of clearing participants. However, key consideration 2 extends the responsibility of the CCP towards the capacity to participants and their customers to manage their risk. The term "capacity" is unclear and might range from reports on positions over tools to providing resources to clients of clearing participants. Since CCPs operating a principal-to-principal model in general have no direct legal relationship with the customers of clearing participants this concept establishes an overly burdensome process with unforeseeable legal consequences and possible liability claims. We would urge the Committee to re-phrase key consideration 2 "to ensure that FMIs enable their participants to manage their own risk and for their clients".

Principle 4: Credit risk

As stated in paragraph 3.4.9. *"Margin requirements should be met by paying funds or pledging collateral, and a CCP should set appropriate standards for eligible assets and establish prudent haircuts to protect against fluctuations in value."*

Comment:

Eurex Clearing would like to clarify that "pledging collateral" is a legal term describing the provision of collateral. However, there are other legal mechanisms, legally even

⁴ Source: latest EMIR version of the European Council dated 15.07.2011 available under <http://register.consilium.europa.eu/pdf/en/11/st13/st13012.en11.pdf> and the latest EMIR version of the European Parliament available under <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2011-0310+0+DOC+XML+V0//EN>

safer, like "title transfer" of collateral. Hence we propose to substitute the term "pledging" with "providing" to allow flexibility of different legal constructs.

The Committees of CPSS and IOSCO request particular responses on the scenarios to cover the "one" or "two" participants and its affiliates to which the CCP has the largest exposure for credit risk under principle 4.

Question 1

What are the pros and cons of establishing for credit risk?

- (1) a "cover one" minimum requirement for all CCPs;
- (2) a "cover two" minimum requirement for all CCPs; and
- (3) either a "cover one" or a "cover two" minimum requirement for a particular CCP, depending upon on the risk and other characteristics of the particular products it clears, the markets it serves and the number and type of participants it has?

Response:

Credit risk is largely covered by margins required from the individual clearing participants (least at 99%). The remaining credit risk is covered through the default fund contribution of the defaulting clearing member and additional risk buffers like other financial resources of the CCP and the default fund contribution of all clearing members.

It is important to note that these buffers can be used only once in the default case. The replenishment of the default fund from non-defaulting clearing members and other financial resources might be possible but not certain in times of market stress.

Eurex Clearing would not welcome the flexibility as defined under (3) as positive. It appears very difficult to judge if certain market structures would suggest a "cover one" or "cover two" coverage. Therefore in order to avoid any regulatory arbitrage as well as competition on risk we believe that a straight definition of required coverage is more appropriate.

From a Eurex Clearing point of view "cover one" is the minimum standard, however in order to be more conservative we believe a "cover two" approach seems appropriate. We would like to note that depending on the timing of the default it is likely that netting effects reducing the overall risks would apply, this would in particular apply if more than two clearing members would default. Therefore Eurex Clearing believes that a "cover two" approach would also provide a sound basis for a multi-member default beyond two.

- (1) a "cover one" minimum requirement for all CCPs;

Pro:

If the clearing member and its affiliates to which the CCP has the largest exposure is covered by the risk buffers (margins, default fund & other financial resources), so would any other (smaller) member.

Con:

Relying on risk buffers (margins, default fund & other financial resources) to cover the credit risk in case of the default of the clearing member and its affiliates to which the CCP has the largest exposure can be problematic in case a second clearing

participants defaults. The immediate replenishment of the default fund and other financial resource might prove difficult (pro-cyclical behaviours of a CCPs should be avoided). Hence, a multi-member defaults might not be covered. Given the close interdependency between the major financial player the assumption of the "one largest" seems not to be reasonable.

Eurex Clearing considers a "cover one" scenario for credit risk as the absolute bear minimum for any CCP.

(2) a "cover two" minimum requirement for all CCPs;

Pro:

A more conservative approach would be to cover the two participants and their affiliates to which the CCP has the largest exposure. Given that margins will be sufficient to cover the largest part of the losses also sufficient resources (default fund and other financial resources) are available to cover excessive losses for a multi-member defaults with high degree of confidence.

Eurex Clearing considers the "cover two" scenario as an acceptable way to structure a secure clearing fund. After largest two or more, in the great majority of cases netting begins to dominate, thus the "largest two plus" could be only a rough metric for identifying worst case scenarios.

Con:

The usefulness of "cover two" depends directly on the structure of the market and the exact method applied. In general, it is a highly conservative scenario. A simultaneous default of the largest two participants has never been observed until today. Lehman Brothers International Europe, so far the biggest default at Eurex Clearing, was by far not the largest member of the clearing house. Hence the biggest downside of this alternative is a potential inefficiency from setting collateral requirements too high.

(3) either a "cover one" or a "cover two" minimum requirement for a particular CCP,

Pro:

This approach would allow flexibility to reflect individual market characteristics.

Con:

CCPs complying with the CPSS-IOSCO principles should be subject to transparent and equal requirements to avoid regulatory arbitrage. This is particularly important since the failure of a CCP, independent of scope and size, can trigger systemic disruptions. Applying different standards would create an un-level playing field since some CCPs need to apply a "cover largest two" requirement whereas other CCPs only need to comply with "cover largest one" requirement.

What potential risk, competitiveness or other concerns might arise if certain CCPs that clear certain products would be subject to a "cover one" minimum requirement, while certain other CCPs that clear other products would be subject to a "cover two" minimum requirement?

How and to what extent could these concerns be addressed?

Response:

Diverging requirements for CCPs create an unlevel playing field and drive a race-to-

the-bottom competition in risk management. Even if this applies to different products it creates unwanted arbitrage incentives among those product groups to minimize collateral requirements. Eurex Clearing does not believe that these risks for the market structure can be adequately addressed. Therefore we strongly believe that a common standard has to be established for all FMIs.

Question 2

Which risk and other characteristics of the products cleared by a CCP are relevant in weighing the pros and cons of a "cover one" versus a "cover two" minimum credit requirement for a CCP? In particular, to what extent are any or all of the following product and market characteristics relevant: OTC versus exchange-traded; mandatory versus voluntary clearing; "cash" versus "derivative" the duration, volatility and degree of leverage; the number and type of CCP participants; the degree of market concentration; and the availability and reliability of prices from continuous, transparent and liquid markets?

Response:

The weighing the pros and cons of a "cover one" versus a "cover two" minimum credit requirement for a CCP is not dependent on product or market characteristics. The key question is first and foremost what is considered as extreme but still plausible market condition in terms of likelihood of the number of defaulting clearing members in the same time period i.e. during the liquidation period, the decision one or two determines the size of the clearing fund respectively other elements in the lines of defence beyond initial and variation margin.

Principle 5: Collateral

Concerning acceptable collateral as mentioned in Paragraph 3.5.2 "[...] participants should not be allowed to post their own debt or equity securities, nor bonds or equity of companies closely linked to them as collateral." In addition "[...] 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."

Comment:

While Eurex Clearing in general agrees with the concept, we propose a re-phrasing such as "Participants should not be allowed to post their own securities, nor securities of companies closely linked to them as collateral according to the definition in the FMI's jurisdiction to the fullest extent possible."

Concerning the mitigation of wrong-way risk, Eurex Clearing would like to state that an ex-ante monitoring or exclusion of wrong-way risk collateral is not viable, as unseen market disruptions can always occur. Thus, it would be quite complex to prevent any type of wrong-way risk collateral on single member level as this is not a stable list of not-acceptable ISINs but can vary depending on market movements. The report should define that wrong-way risk collateral is mainly considered as own issues and closely linked collateral.

According to paragraph 3.5.7 "*Collateral management systems, where appropriate, should allow for the timely calculation and execution of margin calls, the management of*

margin call disputes, and the accurate reporting of levels of initial and variation margins on a daily basis."

Comment:

Eurex Clearing is of the opinion that "management of margin call disputes" is not applicable to CCP clearing. The term "margin call disputes" seems to be derived from the procedures in OTC markets with bi-lateral settlement agreements where counterparties might not be able to agree on margin levels and therefore have disputes. In a CCP environment, the CCP determines margin levels, issues margin calls and must be able to legally enforce them. If participants do not fulfill their margin requirements, they are in default. We propose to delete "*the management of margin call disputes*" in the context of CCPs.

Principle 6: Margin

Key consideration 1 specifies that a "[...] CCP should establish margin levels that are commensurate with the risk and unique attributes of each product, portfolio, and market it serves, taking into account potential increases in liquidation times in stressed markets."

Comment:

Eurex Clearing would like to state that the CCP must use margin and/or collateralization to cover its risk. Key consideration 1 might not be strong enough if it implies that other "arrangements" could be made. Taking into account liquidity aspects of stressed markets, we would like the report to reconsider that these are not solely liquidation times, but also e.g. bid-ask widening aspects amongst others.

According to key consideration 4 "*a CCP should mark participants' positions to market and collect variation margin to limit the build-up of current exposures.*"

Comment:

Eurex Clearing would favor a change in wording from "should" to "must" to set highest possible standards.

Paragraph 3.6.2 states "*The common risk-management tool is a requirement to post collateral in order to protect a CCP against some high percentage of potential future losses on its contracts with its participants.*"

Comment:

Eurex Clearing considers the phrase "some high percentage of potential future losses" to be unclear. We propose a re-wording to "[...] against potential losses to a high degree of confidence [...]" or similar as more appropriate.

Paragraph 3.6.3 requires more conservative margin models for OTC derivatives "*because of their complexity and the greater difficulty of obtaining price quotes.*"

Comment:

OTC products as such do not necessarily require more conservative margins, and this aspect should not be mixed with the potential difficulties to obtain prices. We propose the report to acknowledge that CCPs must carefully consider the liquidity of the

product, as this relates to the ability to hedge, auction, or otherwise liquidate, so that whenever these are more difficult, the margin model must account for it. In addition, the report should state that CCPs have the right to request prices from its clearing members on a daily basis and to implement mechanisms to ensure appropriate price quality.

According to paragraph 3.6.7 *"A CCP should base its close-out period upon historical price and liquidity data when developing its initial margin methodology. [...] Close-out periods should be set on a product-specific basis, as less-liquid products might require significantly longer close-out periods."*

Comment:

The final report should state that "CCPs must map its close-out period to the liquidation procedure. Furthermore, the close-out periods for products or any aggregations of them need to match their expected liquidation periods according to defined procedures. CCPs must first establish a close-out, liquidation, or other wind-down procedures, and once the expected times for these are set, all those products covered by them should not be margined for less than that holding period."

As stated in paragraph 3.6.8 *"Ideally, a CCP would make its margin methodologies available to its participants for use in their individual risk-management efforts."*

Comment:

Eurex Clearing would like to state that CCPs should always make its margining methodology available to its direct and indirect participants.

Paragraph 3.6.11 requires that *"A CCP should have the authority and operational capacity to make ad hoc intraday variation margin calls to participants with positions that have lost significant value."*

Comment:

Eurex Clearing would like the report to define that a CCP "must" have the authority and operational capacity.

As stated in Paragraph 3.6.14 *"A CCP should analyse and monitor its model performance and overall margin coverage by conducting rigorous daily backtesting and at least monthly, if not more frequent, stress testing. A CCP should assess its margin coverage by backtesting using participant positions from each day in order to evaluate whether there are any exceptions to its initial margin coverage."*

Comment:

Eurex Clearing would like to state that model calibration is a slower process, especially if models are made to be less pro-cyclical. However, the margin coverage should be daily, i.e. backtesting need to be done daily. Stress-testing beyond margin should also be done daily in any case. Eurex Clearing would propose the following wording: "A CCP should analyse and monitor its model performance and overall margin coverage by conducting rigorous daily backtesting and by daily stress testing. A CCP should assess its margin coverage by backtesting using participant positions from each day in order to evaluate whether there are any exceptions to its initial

margin coverage. In addition a CCP should have the capacity to run stress tests intraday on an ad-hoc basis".

Principle 7: Liquidity risk

Key consideration 3 states that *"An FMI should maintain sufficient liquid resources (that is, liquid assets and prearranged funding arrangements) 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] and [its/their] affiliates that would generate the largest aggregate liquidity need in extreme but plausible market conditions. A CCP should have sufficient liquid resources to meet required margin payments and effect the same-day close out or hedging of the [one/two] participant[s] and [its/their] affiliates with the largest potential liquidity need[s] in extreme but plausible market conditions."*

Comment:

We regard the requirements for liquidity risk buffers as excessively high, leading to significant cost burden for the FMI and its participants and in contradiction with the principle of efficiency. In contrast to the treatment of credit risks, where collateral to cover potential losses is frozen in the moment of a participant's default and can be used only once, liquidity requirements have to be assessed in a dynamic way considering cash flows over a relevant liquidation period. On the one hand not all payments need to be made on the day of a default, on the other hand refinancing over the default period is possible. It is important to note, that liquidity is only necessary to interim finance the liquidation of open positions. Liquidity buffers are not intended and used for loss absorption. Hence, for a conservative liquidity risk management we propose that the report limits the required liquid resources to be sufficient to cover the default of the one participant with the largest liquidity exposure.

If a CCP has access to collateralized central bank liquidity this should be considered as part of the liquidity plan. We believe that in particular in stress scenarios access to collateralized central bank liquidity is an important source to ensure immediate availability of liquidity for an orderly liquidation process. It is important to note that an FMI only needs such liquidity in an extraordinary situation; maintaining liquidity in form of cash or permanent credit lines for commercial bank money will lead to unintended consequences

- Negative impact on returns e.g. of buy-side firms like pension funds for providing cash instead of securities as collateral
- Holding high amounts of cash in FMIs will reduce available liquidity in the overall market, which might negatively impact the functioning of the financial markets in general
- Unnecessarily high costs for the CCP and its participants due to the requirement to maintain costly credit lines just for highly unlikely stress scenarios

Key consideration 8 states that *"an FMI's rules and procedures should also indicate its process to replenish its liquidity resources it may employ during a stress event,*

including the default of the two participants and their affiliates that would potentially cause the largest combined liquidity needs [...]"

Comment:

Key consideration 8 asks for liquidity resources to cover the default of the two participants and their affiliates with the largest exposure. This is in contrast to key consideration 3 asking for sufficient liquid resources to cover the default of the [one/two] participant[s] and [its/their] affiliates that would generate the largest aggregate liquidity need in extreme but plausible market conditions. Key consideration should be re-phrased to be in line with key consideration 3.

Paragraph 3.7.1 describes that *"Depending on the design of an FMI, liquidity risk can arise between the FMI and its participants, between the FMI and other entities (such as its settlement bank, nostro agents, custodian banks, and liquidity providers), or between participants in an FMI (such as in a DNS payment system, CSD, or SSS)."*

Comment:

Eurex Clearing is of the opinion that Paragraph 3.7.1 is too far reaching. The report shall not require a CCP to manage the liquidity risk between participants in an FMI.

Paragraph 3.7.7 requires *"an FMI should seek to manage or diversify its settlement flows and liquid resources to avoid an excessive concentration with one entity."*

Comment:

Eurex Clearing acknowledges the need for diversification to avoid excessive exposures to individual counterparties. However, diversification is likely to cause less efficient processes. High levels of concentration, e.g. usage of only one settlement bank in a certain currency, do not necessarily threaten a CCP, if the amounts involved are immaterial. Therefore, we suggest replacing "concentration with" with "exposure to".

Paragraph 3.7.10 requires that *"committed lines of credit in themselves may be used as a source of liquidity, but may not be double-counted as liquid resources."*

Comment:

Eurex Clearing would appreciate a clarification of the difference between "source of liquidity" and "liquid resources" and how to apply these to the liquidity plan. In addition, paragraph 3.7.10 seems to contradict paragraph 3.7.8.

As mentioned in paragraph 3.7.14 *"An FMI should determine and test the sufficiency of its liquid resources by regular and rigorous stress testing. [...] Stress testing should be performed at least monthly, and more frequently when markets are unusually volatile, less liquid, or when the size or concentrations of positions held by its participants increase significantly. In addition, more routine daily or weekly stress testing in which a CCP stresses the current positions of its participants using established parameters and assumptions should be considered to be a best practice."*

Comment:

Eurex Clearing is of the opinion that FMIs should be able to construct their stress tests for liquidity resources at their own discretion to cover scenarios that are relevant for its liquidity risk given its specific risk profile, e.g. historic volatilities, yield curves

etc. We do not deem daily stress tests for liquidity resources as appropriate as liquidity requirements are largely insensitive to market price risk.

The Committees of CPSS and IOSCO particularly request comments with respect to the following additional points related to Principle 7 – Liquidity risk:

Question 1

What are the pros and cons of establishing for liquidity risk (1) a "cover one" minimum requirement for all FMIs; (2) a "cover two" minimum requirement for all FMIs; and (3) either a "cover one" or a "cover two" minimum requirement for a particular FMI, depending on the risk and other characteristics of the particular payment obligations it settles, the products it clears, the markets it serves and the number and type of participants it has? What potential risk, competitiveness or other concerns might arise if certain FMIs that settle certain payment obligations or that clear certain products would be subject to a "cover one" minimum requirement, while certain other FMIs that settle certain other payment obligations or that clear certain other products would be subject to a "cover two" minimum requirement? How and to what extent could these concerns be addressed?

Response:

In contrast to the treatment of credit risks, where collateral to cover potential losses is frozen in the moment of a participant's default and can be used only once, liquidity buffers have to be assessed in a dynamic way considering cash flows over a relevant liquidation period. On the one hand not all pay-outs need to be made on the day of a default, on the other hand refinancing over the default period is possible. It is important to note, that liquidity is only necessary to interim finance the liquidation of open positions. Liquidity buffers are not intended and used for loss absorption. Hence, for efficiency reasons while maintaining a conservative liquidity risk management we propose that the report limits the required liquid resources to be sufficient to cover the default of the one participant with the largest liquidity exposure.

In addition, we regard the requirements for liquidity risk buffers as excessively high, leading to significant cost burden for the FMI and its participants and in contradiction with the principle of efficiency.

With regards to the optionality for a "cover largest one" or "cover largest two" requirement we would like to urge that the CPSS-IOSCO principles opt for an equal treatment of all CCPs. Particularly with respect to liquidity requirements and the associated costs an unequal treatment would lead to an un-level playing field.

Question 2

Which risk and other characteristics of the products cleared by a CCP are relevant in weighing the pros and cons of a "cover one" versus a "cover two" minimum liquidity requirement for a CCP? In particular, to what extent are any or all of the following risk and other characteristics of the payment obligations settled or the products cleared by an FMI relevant: OTC versus exchange-traded; mandatory versus voluntary clearing; "cash" versus "derivative"; the duration, volatility and degree of leverage; the number and type of CCP participants; the degree of market concentration; and the availability and reliability of prices from continuous, transparent and liquid markets?

Response:

Referring to the risk and other characteristics of the products cleared by a CCP that are relevant on weighing the pros and cons of the supported minimum requirement approach, Eurex Clearing would like the report to take into consideration that even if exposure and concentration limits are used, participants might use the same settlement bank and hence exceed limits. This cannot be prevented by the CCP.

Traditional cash market products tend to require more liquidity in "failure-to-pay" defaults, while derivatives products (OTC and on-exchange) require more liquidity in actual insolvency situations. The ability for the CCP to re-finance respective products overnight towards the central bank or commercial banks while providing collateral is key in this regard. The absolute amounts to be financed are higher in the cash market, but it can be refinanced to a high degree by entering into repurchase agreements. The derivatives related payment obligations (variation margin / options premium) are smaller, but need to be financed outright. Based on these characteristics, the scope of products cleared by a CCP is influencing the actual liquidity requirements. A member's insolvency might actually not impose the largest liquidity requirement to a CCP, as the chosen settlement processes for cash market products can influence this significantly.

Principle 8: Settlement finality

Paragraph 3.8.3 indicates that *"An FMI's processes should be designed to, at a minimum, complete final settlement no later than the end of the value date. This means that any payment, transfer instruction, or other obligation that has been submitted to and accepted by an FMI, in accordance with its risk-management and other relevant acceptance criteria, should be settled on the intended value date."*

Comment:

Given that CCPs do not have central bank money access in all currencies required, commercial bank settlement risk consequently needs to be accepted during the day. Eurex Clearing is of the opinion that it is not possible to receive a final settlement confirmation from any commercial bank intra-day (this is the difference between payment systems protected by the Settlement Finality Directive and all others). We consider Paragraph 3.8.3 as too strict and propose that the report recognizes that complete final settlement might not be achieved at the end of the value date. We therefore propose to reword the paragraph to allow for more flexibility *"An FMI's processes should be designed to complete final settlement, in general, no later than the end of the value date."*

As outlined in paragraph 3.8.6 *"An FMI should clearly define the point before settlement after which unsettled payment or transfer instructions or obligations may not be revoked. In general, an FMI should prohibit or discourage the unilateral revocation of accepted and unsettled payment or transfer instructions or obligations after a certain point or time on the settlement day, so as to avoid creating liquidity risks."*

Comment:

Eurex Clearing would welcome the report to consider that the CCP has limited influence on the revocation of transfer instructions. CCPs depend on the rules of the

CSD, which can allow unilateral cancellations irrespective of CCP rules. Whenever a CCP has received a Power of Attorney, i.e. if the CCP sends all match instructions, the CCP depends on the release instructions of its members to be allowed to instruct the members' settlement accounts. If the members revoke a preliminary released instruction the CCP will cancel a pending instruction at the CSD awaiting further release instructions.

Principle 9: Money settlements

Paragraph 3.9.5 indicates that *"In addition, an FMI should take further steps to limit its credit exposures and liquidity pressures by diversifying the risk of a commercial settlement bank failure, where reasonable, through the use of multiple commercial settlement banks and the use of concentration limits."*

Comment:

Eurex Clearing would like the report to consider that when using one or more commercial banks, there is a trade-off between the diversification of settlement risk and efficiency. Spreading liquidity among a number of commercial banks may adversely impact settlement efficiency, as funds need to be realigned between banks. Thus, we agree with the Committees of CPSS-IOSCO that – where reasonable – a CCP should be allowed to decide on the level of diversification. In particular, it should be allowed to concentrate funds with one bank, if settlement volumes are not material enough to impair the CCP's solvency, should the bank default.

Principle 10: Physical delivery

Eurex Clearing does not have any comments on this principle.

Principle 11: Central securities depositories

As mentioned within key consideration 6 *"A CSD providing central safekeeping and settlement services to a CCP should ensure that the CCP would not pose additional material risks (such as liquidity and operational risk) as compared to any other participant in the CSD and, where necessary, takes additional measures."*

Comment:

Eurex Clearing would like to highlight that a CCP exclusively offering clearing services reduces risk by novation or open offer as compared to any other participant in the CSD, i.e. a CCP minimizes counterparty risk, credit risk, market risk, liquidity risk, transaction risk and operational risk. Hence, a CCP should receive exceptional position within the CSD's settlement and custody processes for sound and robust operation, e.g. by receiving first priority in delivery management and collateral management as additional measures.

Principle 12: Exchange-of-value settlement systems

As stated in key consideration 1 *"An FMI that is an exchange-of-value settlement system should eliminate principal risk by linking the final settlement of one obligation to the final settlement of the other."*

Comment:

Eurex Clearing's understanding is that the exchange-of-value settlement systems are used for cash or foreign exchange transactions but not used for securities. Hence key consideration 1 is not applicable to CCPs performing securities settlement.

Principle 13: Participant-default rules and procedures

As mentioned in paragraph 3.13.1 *"Participant-default rules and procedures facilitate the continued functioning of an FMI in the event that a participant fails to meet its obligations and help to limit the potential for the effects of a participant's failure to spread to other participants. In some instances, managing a participant default may involve hedging open positions, funding collateral so that the positions can be closed out over time [...] An FMI may also decide to auction or allocate open positions to its participants."*

Comment:

Eurex Clearing proposes the report to require a CCP to establish an auction and allocation procedure.

In general, it is crucial to ensure that CCPs take all possible steps to ensure continuity of the market and CCP, and that the participants are aware of how extreme situations would be treated. Additionally, defining the sequence of actions at tail events, or where members do not actively participate in the default management, also serves to strengthen the reasonable behavior of the market, given that major market turbulence will then directly involve and affect the members and the CCP. This creates strong incentives to act responsibly, since any losses will ultimately be paid for by the participants and the CCP. Such last resort procedures are also key to clarifying how extreme losses are absorbed by the CCP and the market, as well as how CCP defaults can occur.

As outlined in paragraph 3.13.3 *"An FMI's participant-default rules and procedures should enable the FMI to take timely action to contain losses and liquidity pressures, before, at, and after the point of participant default (see also principle 4 on credit risk and principle 7 on liquidity risk). Specifically, an FMI's rules and procedures should allow the FMI to use promptly any financial resources that it maintains for covering losses and containing liquidity pressures arising from default, including the use of liquidity facilities."*

Comment:

Eurex Clearing would welcome the report to clearly state that CCPs have the flexibility and discretion to sanction any member not actively assisting the CCP or promoting orderly markets during a liquidation, e.g. by prior-ranking the member for clearing fund usage before usage of the CCP's own contribution.

As stated in paragraph 3.13.4 *"The CCP's rules and procedures should clearly state the scope for such action, and any and all obligations faced by participants with regard to*

such auctions should be clearly set out. As with the application of posted collateral, the close out of positions should not be subject to prevention, stay or reversal under applicable law and the rules of the FMI."

Comment:

Eurex Clearing would like the report to consider that the scope of auctions can be expressed, but not guaranteed. To "clearly state" within the rules what the exact obligations of such auctions are, may compromise the flexibility a CCP could require in extreme or otherwise difficult situations. Thus, we suggest an approach which states "for purposes of market and CCP integrity, the CCP may use its discretion in respect to auction details"

Principle 14: Segregation and portability

Key consideration 2 states that *"A CCP should employ an account structure that enables it readily to identify and segregate positions and collateral belonging to customers of a participant."*

Comment:

Key consideration 2 can be understood in a way that "identify and segregate" implies that all assets have to be segregated. This is (if intended) undesirable as certain clients would not necessarily require segregation – i.e. the level of segregation should be the client's choice. Clients should be free to choose to opt-out of client protection regimes. Where a client chooses segregation the CCP has to identify and segregate positions and collateral in an omnibus or individual account.

Key consideration 3 requires *"A CCP should structure its arrangements in a way that facilitates the transfer of the positions and collateral belonging to customers of a defaulting participant to one or more other participants."*

Comment:

It should be considered that due to national laws transfer of positions and collaterals is achieved in different ways. For example sometimes a close out netting and reopening mechanism is achieving portability without legally transferring a position. Accordingly, we would welcome the report to state that a 'transfer' can be achieved by a number of different mechanisms and that additional prerequisites can be set by a CCP.

Key consideration 4 states that *"a CCP should clearly disclose its rules, policies, and procedures relating to the segregation and portability of customer positions and collateral."*

Comment:

The high-level principles as drafted fail to recognize that the clients of participants should be able to choose the level of segregation, and therefore, portability, as appropriate to their business requirements. Similarly, the principle does not recognize that the money and assets which are posted as collateral may belong to clients of a

participant under a domestic regime for the protection, distribution and/or transfer of client assets.⁵ Assets which are the subject to the domestic client assets protection regime should be segregated throughout the intermediation chain and be segregated at CCP level.

Paragraph 3.14.4 states *"In order to fully achieve the benefits of segregation and portability the legal framework applicable to the CCP should support its arrangements to protect the positions and collateral of a participant's customers."*

Comment:

Segregation and especially portability requires not only the national law of the CCP to support its required arrangements. Also, due to very heterogeneous European insolvency laws, the respective national law of its clearing members and their clients must support the arrangements.

Paragraph 3.14.7 offers *"Another approach would be to use an omnibus account structure where all collateral belonging to all customers of a particular participant is commingled and held in a single account."*

Comment:

It should be considered that the omnibus account structure probably only achieves segregation but will fail to achieve portability. This is important especially in the context to achieve business continuity for customers.

According to paragraph 3.14.10 *"A CCP should design its segregation regime in a manner that provides customers with legal certainty that their collateral will be protected to the greatest extent possible under applicable law [...]. 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."*

Comment:

Excess collateral is any collateral held above the margin requirement and if passed on to the CCP it should be protected as well. The clearing participant may request additional margin above what the CCP has called. Thus, Eurex Clearing would welcome the report to state that the excess collateral held by the clearing participant should be subject to the jurisdiction's client asset protection regime, if it is not passed to the CCP.

As mentioned in paragraph 3.14.11 *"In designing its segregation arrangements, a CCP should be mindful of laws or regulations that require a participant to segregate all customer collateral and endeavour to take steps to ensure its segregation arrangements are consistent with those laws and regulations. In the absence of such a legal or regulatory segregation requirement, the CCP should consider requiring participants to segregate positions and collateral belonging to customers to the fullest extent possible."*

Comment:

Even if mandated - in the absence of such a legal or regulatory segregation

⁵ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD351.pdf>

requirement - it needs to be considered that CCPs usually are not in a position to monitor adequately if their market participants would segregate positions and collateral belonging to customers accordingly. It needs to be the responsibility of regulators and supervisors ensuring that such rules are applied by the participants.

The Committees of CPSS and IOSCO particularly request comments with respect to the following additional points related to Principle 14 – segregation & portability:

Question 1

What are the different models and approaches to establishing segregation and portability? What are their pros and cons respectively, for example in terms of efficiency and level of protection that can be achieved?

Response:

Eurex Clearing intends to provide three options for client asset segregation:

- Individual clearing model
- Omnibus clearing model
- No segregation

By introducing the Individual Clearing Model Eurex Clearing will offer, to a maximum extent possible, full segregation of positions and collaterals and allow for portability.

Customer positions will be booked in individual accounts totally separate from those of its clearing member and other customers. Customer assets are protected via a specific pledge construct and are portable through a close out netting and reopening approach. The portability will not depend on the approval of the insolvency administrator and therefore allow the customer to manage its risk and take up trading activities near time.

The envisaged omnibus model, with all collateral and positions belonging to all customers of a particular participant are held in a single account. While this model also offers segregation of collateral and positions from the respective participant's accounts, portability might be difficult as the identification of the individual positions and collateral is more complex than it will be by using the Individual clearing model. Portability will be possible, if the whole omnibus account can be transferred to a new clearing member.

Question 2

In view of the different options and models that may exist, is there any one option or model in particular that could usefully serve as a minimum requirement? Would it be possible to identify a specific approach to segregation and portability that could be defined as best practice?

Response:

Along the currently discussed EMIR principles it is important that customers have the choice between different protection levels offered by the CCPs. Choice means that cost aspects but especially protection aspects have to be considered. A pure minimum protection might not be sufficient; customers should be given the possibility to opt for full protection.

Question 3

Would it be helpful to distinguish between different types of customers, such as by the degree of tiering or by domestic or cross-border activity? Please explain.

Response:

Eurex Clearing does not see any benefit in mandating specific solutions for certain types of clients.

Question 4

Would it be helpful to distinguish between different types of products? If so, please explain why and how.

Response:

Segregation solutions should cover all products cleared by a CCP. A distinction of regimes between different types of products will not be helpful.

Question 5

What are the existing legal constraints that limit segregation and portability?

Response:

In order to guarantee legal certainty with regard to segregation and portability arrangements, different national laws for all relevant jurisdictions urgently need to be aligned. Especially the complex and heterogeneous insolvency laws in Europe make a standardized and cost effective client protection offering very difficult for CCPs. The same complexities arise for CCPs offering their services both in the US and Europe.

Principle 15: General business risk

As required in key consideration 3 *"At a minimum, an FMI should hold equity capital at normal times equal to [six, nine, or twelve] months of expenses."*

Comment:

Eurex Clearing supports an approach that stipulates to hold equity capital at normal times equal to six months of expenses. Furthermore, the rule for avoidance of double regulations should be more clearly defined. We would suggest stating that in case the risk is covered by international risk based capital standards or operational risk charge under the Banking rules as defined by BCBS, these are treated as being a substitute in order to avoid double regulation.

Principle 16: Custody and investment risk

Eurex Clearing does not have any comments on this principle.

Principle 17: Operational risk

According to Paragraph 3.17.4 *"an FMI should comply with, or, depending on the FMI's importance and level of interconnectedness, exceed the relevant industry's best practices."*

Comment:

Eurex Clearing would request clarification on how the requirement can be assessed and measured. The wording should be corrected to say "to meet the relevant industry's best practices."

Principle 18: Access and participants requirements

Key consideration 1 and paragraph 3.18.1 state: *"Access refers to the ability to use an FMI's services and includes the direct use of the FMI's services by participants, including other market infrastructures (for example, trading platforms) and service providers (for example, matching and portfolio compression service providers). In some cases, this includes the rules governing indirect participation. An FMI should permit fair and open access to its services. "*

Comment:

The consultation document requires broad access for other infrastructures and service providers beyond access for participants and indirect participants and other FMIs as defined in the CPSS-IOSCO consultation document, namely CCPs, CSDs, SSSs and TRs. While access requirements for participants and FMIs are defined in the CPSS-IOSCO document, risk-based access requirements for "other market infrastructures and service providers" are not defined.

Mandating access for FMIs and "other market infrastructures and service providers" leading to interconnectivity among infrastructures will substantially raise systemic risks and undermines market integrity. Furthermore, it is not in line with the legal frameworks in many countries.

Access in the document should only refer to the ability to use a CCPs services including the direct use of the CCPs' services by participants and indirect participants. The requirements for links between FMIs are outlined in Principle 20.

We propose to delete the reference to FMIs and "other market infrastructures and service providers".

Paragraph 3.18.2 requires *"An FMI's participation requirements should therefore encourage broad access, including access by participants, other market infrastructures, and where relevant service providers, in all relevant jurisdictions, based on reasonable risk-related participation requirements."*

Comment:

We strongly disagree with a wording that requires a CCP to encourage interconnectedness between market infrastructures. Linkages between market infrastructure increase systemic risk and create new legal and operational risks. CCPs should first and foremost obey to the principle of maximizing market safety and integrity.

Access in the document should only refer to the ability to use a CCPs services and include the direct use of the CCPs' services by their participants and indirect participants.

Principle 19: Tiered participation arrangements

Comment:

Principle 19 shifts responsibilities of risk management for indirect participants towards the CCP. Most CCPs maintain a legal relationship on a principal-to-principal basis with their direct participants but not directly with the customers of its direct participants. Given that there are no legal relationships with indirect clients (e.g. clients in omnibus account) it appears impossible for a CCP to impose or enforce any kind of direct risk management or monitoring. The report should acknowledge that where CCPs follow a principle-to-principle model and do not have a legal relationship with indirect clients that the CCP should not be subject to Principle 19.

A CCP should be responsible for managing its own risks and that of its direct participants, providing risk management services and information to enable its direct participants to manage their own risks and act as intermediaries for their clients. In addition, CCPs should provide risk management services and information to enable direct participants to monitor and manage the risk of their clients.

Paragraph 3.19.2 states *"For the purposes of this principle, an FMI can have two types of relationships that affect tiered participation arrangements. The first type of relationship is with participants in the FMI that are bound by the FMI's rules and agreements. [...] The second type of relationship is with entities that are not bound by the rules of the FMI, but whose transactions are recorded, cleared, or settled by or through the FMI. These entities are defined as "indirect participants" in the FMI for the purposes of this principle."*

Comment:

Eurex Clearing is concerned about the definition of indirect participants. A differentiation should be made between customers of direct participants that sign a tri-partite-agreement, and those that only sign a bilateral agreement with the clearing member. The CCP can exercise certain rights or apply certain monitoring towards indirect customers bound by a tri-partite-agreement (i.e. such an indirect participant is acknowledging the Eurex clearing conditions) and therefore is known to the CCP. However the CCP cannot exercise any rights or apply any monitoring towards indirect customer having no contractual relationship and are therefore not known to the CCP.

Paragraph 3.19.6 states *"Poor management of the default of an indirect participant could in some circumstances generate disruptions within the FMI and the broader financial markets. To the extent practicable, an FMI should ensure that its default and loss-sharing arrangements can manage the transaction flows that might be generated by such a default, recognising that the visible net flows of a direct participant could disguise imbalances between the regular flows of the direct participant and its associated indirect participants. If an FMI identifies direct participants acting on behalf of large indirect participants, the FMI should also ensure it has adequate information to understand such direct participants' processes and procedures (such as rescinding future dated transactions) for managing an indirect participant default and whether such processes and procedures can be scaled up to deal with the default of a large indirect participant, without exposing the FMI to operational and reputational risks."*

Comment:

Eurex Clearing deems the requirements inappropriate particularly in combination with the definition given in paragraph 3.19.2. Handling the default of indirect participants is the responsibility of the direct clearing participant who acts as intermediary for these customers on multiple markets worldwide. To request a CCP to understand the direct participants' processes and procedures would require the CCP to not only assess the default rules of all CCPs that this direct participant clears with but also have insight in the contractual relationship between the clearing member and the indirect customer. We clearly see that not as an obligation of CCP, but as primary task for regulators supervising that clearing member.

Paragraph 3.19.7 states: *"The default of an indirect participant could also raise legal and operational uncertainty for the FMI. For example, there may be uncertainty about whether the indirect participant remains principal to an underlying deal. The status of transactions that are at various points of their life cycle may also be unclear when an indirect participant defaults. An FMI should therefore review its rules and procedures to ensure there is clarity about the nature of participation of direct and indirect participants and, to the extent practicable, ensure there are no additional legal, contractual, or finality issues resulting from indirect participation. The outcome of reviewing these issues should be reported to and agreed to by the board of directors. The review should be updated periodically and after substantial amendments to an FMI's rules."*

Comment:

Eurex Clearing regards the requirements within this paragraph as inappropriate and a far too large scope for a CCP. With the definition given in 3.19.2, a CCP does not even have information about the jurisdictions of all indirect participants having no legal relationship with the CCP. To investigate legal, contractual, or finality issues in multiple jurisdictions is impossible and the potential conflict-of-law issues are significant. It must remain the responsibility of a clearing member to investigate legal, contractual and finality issues resulting from client clearing. The CCP sets high admission requirements on direct participants to ensure that such firms are stable enough to cover a client default situation. The requirements stated within paragraphs 3.19.6 and 3.19.7 should be the duty of the regulatory authority supervising the clearing participants. In addition, we recommend a significant revision of the whole principle to avoid additional oversight burdens / duties for CCPs, while rather the regulatory authorities of clearing members are required to perform these functions. Further, the definition of "indirect participation" requires revision as outlined before.

Principle 20: FMI links

As mentioned in paragraph 3.20.13. *"A CCP may have to post margin with another linked CCP for open positions. In some cases, the CCP may not be able to post margin that it has collected from its participants to the linked CCP because the first CCP's rules may prohibit the use of its participants' margin for any purpose other than to cover losses from a participant default."*

Comment:

Eurex Clearing would like the report to state that in respect to the use of participants' margin, it has to be ensured that only additional collateral of the participant is used for

securing the link risks. Collateral, which has been collected to secure the participant's position vis-à-vis the CCP must not be used to secure the CCP link.

The CPSS and IOSCO acknowledge that links are an important source of additional operational and financial risks, which call for more stringent requirements. Against this background, the CPSS and IOSCO committees specifically request comment on challenges associated with establishing links between FMIs.

Response:

Mandating links and interoperability between CCPs introduce new systemic risks to the financial system, and thus work against the aims of increasing market integrity and stability while also reducing market efficiency:

- CCP links create new risk exposures. Especially when two large markets with an overlapping member community become interoperable, trading volumes will significantly distribute across these CCPs, thereby generating high risks on the CCP link.
- In addition, interoperable CCPs continue to be subject to their national insolvency laws. Differences in these insolvency regimes will increase complexity in the default handling of each CCP.

The definition of joint risk models for the cross-CCP risk, especially under the requirement to strictly maintain high risk standards has proven as one key obstacle. Especially for links which would be built in a competitive scenario, it will prove difficult to find common grounds for the inter-CCP risk model. In case of links in the derivatives markets the systemic risks will increase dramatically.

Principle 21: Efficiency and effectiveness

As outlined in paragraph 3.21.3 *"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."*

Comment:

Eurex Clearing agrees that an FMI should thrive for safety and efficiency for the benefit of the overall financial markets, while maintaining a successful business case to sustain its operation and investments. However, we consider "efficiency" as difficult to measure uniformly across the various FMIs.

To consider its participants' liquidity costs, including 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 should not lie with the FMI for two reasons:

Risk management aspects of CCPs drive the type of accepted collateral. Cost aspects for individual participants can and should not be the priority. A clear and transparent guidance on the accepted collateral and applied haircuts should be provided by the CCP however.

Cost structures of participants might be very heterogeneous and cannot be controlled outside the respective departments of the participants.

From Eurex Clearing perspective it is the primary role of rule makers and supervisors to ensure that the rules are well balanced between safety and efficiency.

We would ask for a deletion of that whole phrase.

Principle 22: Communications procedures and standards

Eurex Clearing does not have any comments on this principle.

Principle 23: Disclosure of rules and key procedures

Eurex Clearing does not have any comments on this principle.

Principle 24: Disclosure of market data

Eurex Clearing does not have any comments on this principle.

C. Closing

We hope that you have found these comments useful and remain at your disposal for further discussion. If you have any questions please do not hesitate to contact:

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