KRX (Korea Exchange, SSS & Exchange CCP)

(Principle 4: Credit risk)

In terms of the minimum requirements of financial resources to brace for a potential credit loss, we support “the cover 2 option” based on the following rationale.

In any stress scenarios, FMI’s financial resources would be the first line of defense which could prevent systemic risk from spreading. More strengthened financial resources of FMIs in accordance with the cover 2 option would allow the FMIs to cope with their financial stress caused by participants (or their affiliates or both), in a more timely and orderly manner, which is expected to create virtuous cycle by keeping the possibility of systemic risk in check at early stages.

If a CCP’s financial resource set aside based on cover 1 option is not enough to cover credit loss under realized “extreme but plausible stress scenarios”, it would be inevitable for the CCP to call for additional fund contributions from its participants, which in turn would exacerbate the participants’ financial viabilities.

As of now, KRX doesn’t employ such an additional fund contribution scheme. However, if the scheme is introduced and granted to KRX, we believe that such an exceptional measure should be considered to put into practice under very limited circumstances with clear and transparent objectives. Therefore, strengthening FMI’s first line of defense to brace for a participant’s (or their affiliates or both) default under normal situation, through procuring enough financial resources, will be very important to keep more grueling scenarios under control, which explains the appropriateness of cover 2 option.

(Principle 7: Liquidity risk)

We also support “the cover 2 option” as a means to keep liquidity risk in check.

In case of sudden fluctuations of price volatilities or unexpected financial crisis, FMI’s intraday liquidity resources will be an important buffer to mitigate the possibility of systemic risk by carrying out its liquidity obligations in a timely manner. Considering this, it looks more desirable for an FMI to secure enough intraday resources to deal with defaults of more than 2 participants (or their affiliates or both)

Meanwhile, with regard to a measure to stabilize market liquidity strains, it looks necessary for central bank to develop and employ a scheme to provide FMIs with emergency intraday liquidity supports, in return for the FMIs’ risk-free securities (or other eligible assets) as a collateral. Without such a scheme, FMI would be forced to sell their collateral assets to the market to meet its intraday liquidity obligations, which will be a serious concern of both FMIs and authorities with the possibility of amplifying the relevant volatility and “fire sale” of the assets that we’ve experienced during the past financial disruption in the US.

(Principle 4 and 7: Stress testing scheme)

In terms of the stress testing methodology, we hope that the pertinent principles could give us a concrete guideline for modeling and testing schemes, such as minimum requirements for fitting the model or statistical basis. We are not saying that the principles should introduce recommendations on a particular model (e.g. VaR etc.) However, it seems to be needed to stipulate some of the bit more technical requirements of stress testing schemes (like 99% single-tailed confidence level in the margining principle) so that FMIs can take them into their own considerations.

Additionally, it looks to be needed to stipulate more clearly about the cycle of the back-testing and products subject to the test.

With regard to the reverse stress testing, practicality seems to be a bit skeptical, considering extreme complexities of the relevant modeling.

KSD (Korea Securities Depository, CSD&SSS)

(Principle 4: Credit risk and Principle 7: Liquidity risk)

Considering the importance of FMIs' viability to carry out its financial obligations, Cover 2 option looks more appropriate.

(Principle 15: General business risk)

We hope that the relevant principle should make a clear choice among the three possible options (earmarked capital for six, nine or twelve months' operating costs) as a best practice and stipulate it in the principle. Considering many other parts of the principles that their bar has been raised, without such a stipulation, most of the FMIs would prefer the six month option with an intention to economize their resources relevant to the general business risk.

KFTC (Korea Financial Telecommunication and Clearing institute, Retail payment system)

(Principle 15: General business risk)

Considering systemic importance of FMIs, it will be appropriate to introduce the general business risk principle to encourage FMIs to keep tabs on every angle of financial disruption.

However, it looks needed to consider each FMI's legal structure/basis when applying the principle to the relevant FMIs. In case of an FMI whose legal basis is a non-profit organization and employs a user-owner model as its governance structure, placing a separate requirement with a sole purpose to deal with general business risk could be a too much burden for the FMI and distort their business in some extreme cases by providing them with an incentive to circumvent the principle. As you are aware, a non-profit organization with a user-owner governance structure has far less incentive to take a risky general business than its for-profit counterparties, while having a conservative approach as much as possible. When taking those into accounts, applying the relevant recommendations on both players uniformly without appropriate considerations on the differences in profit making incentives (in terms of general business) and governance structure looks too mechanical, in terms of both feasibility and practicality.

Therefore, we hope that the principle relevant to general business risk could allow a non-profit FMI to have some leeway to be exempted from the capital requirements for general business risk or be permitted to minimize the pertinent financial resources within an acceptable and rational range. And we also hope that prudential authorities and central banks take a cautious approach on that account.