

# **CCP12 – The Global Association of Central Counterparties**

## **Comments**

### **CPSS-IOSCO consultative reports**

**Guidance on the application of the 2004 CPSS-IOSCO  
Recommendations for Central Counterparties to OTC  
derivatives CCPs, May 2010**

**&**

**Considerations for trade repositories  
in OTC derivatives markets**

## A. Introduction

CCP12 welcomes the opportunity to comment on the May 2010 consultative reports, “Guidance on the application of the 2004 CPSS-IOSCO Recommendations for Central Counterparties to OTC derivatives CCPs” and “Considerations for trade repositories in OTC derivatives markets” of the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO).

CCP12 - The Global Association of Central Counterparties, was formed in 2001, and is currently comprised of some 28 member organizations encompassing over 35 central counterparty clearing houses (CCPs) across Europe, Asia and the Americas. CCP12 members operate CCPs across an extensive range of OTC and exchange-traded markets, both cash and derivatives, across multiple asset classes, including equities, fixed income, foreign exchange, credit derivatives, commodities and energy.

It is with this background that CCP12 puts forward its submission to the CPSS/IOSCO consultative report.

## B. Comments

### **Comments on Section 3: ‘Distinctive features of OTC derivatives CCPs and the need for tailored guidance’**

This section gives an impression that all OTC derivatives are quite tailored and complex. In reality, there are quite many OTC derivatives that are plain vanilla (e.g. look-alike products to exchange traded products) which do not present the same challenges as are described in this section. Since such products do not present the same challenges and are easier to clear, it would be desirable that this is recognized in the guidance.

*Para 2(b): ‘there are multiple electronic trading venues for OTC derivatives markets that are in various stages of development. Such conditions result in trading environments less closely integrated with the CCP and may therefore cause concerns with regard to the processing efficiency, operational reliability, interoperability and open access.’*

Comments: There are prudential concerns over interoperability between CCPs but the extent of concerns for a CCP or CCPs serving multiple execution venues is of a much lower order. CCPs however agree with the guidance that CCPs should be able to decide on the basis of their risk management requirements whether to grant access to trading platforms to the services of the CCP.

*Para 2(f): ‘As the international regulatory community promotes greater use of CCPs for OTC derivatives markets, a growing number of market participants are likely to seek access to OTC derivatives CCPs abroad especially if there are no feasible domestic alternatives..... Therefore, an OTC derivatives CCP may need to pay close attention to cross-border aspects of legal and operational arrangements. It also may need to consider the use of bespoke participation requirements, the segregation and portability of indirect participants’ positions and margins, and how it can incorporate these varied participants into its governance structure’*

**Comments:** Cross border aspects of legal arrangements, especially in regard to collateral and insolvency related provisions are of vital importance. To achieve a satisfactory level of assurance, Regulators and Governments in various countries need to take urgent action to harmonise related legal provisions across borders.

*Para 2(g): ‘An OTC derivatives CCP must consider in its governance process the appropriate rules and management of the risks it takes on, its role in the market as a source of stability, as well as conventions, standards and protocols widely adopted by market participants.’*

**Comments:** As the paper says, ideally over time, CCPs should be able to be involved in the development of those standards. Moreover, if some standards need review because of the introduction of CCPs in those markets – which can happen mainly at two levels, operational processes and default handling - regulators can facilitate such change for optimum efficiency.

#### **Comments on Section 4: ‘Descriptions of the proposed guidance on the application of the RCCP to OTC Derivatives CCPs’**

*Recommendation 1: “In the OTC derivatives market, there are industry standards and market protocols that apply to CCPs clearing these products. It is important for OTC derivatives CCPs to be transparent about the role of such standards and protocols in their rules, procedures and contracts.”*

**Comments:** CCPs may make their own assessments of the suitability of existing market standards and establish their own requirements should these be necessary to ensure an adequately robust and successful clearing service for the product.

*Recommendation 2: Participation Requirements: ‘Where non-regulated entities are admitted to participate in an OTC derivatives CCP, it is important that the risks should be appropriately mitigated by its participation requirements and other appropriate measures.’*

**Comments:** While similar risks exist in other markets as well, it is agreed that the extent of risk is more significant in case of non-regulated entities in OTC Derivatives markets and appropriate risk mitigants, therefore, need to be in place.

*Recommendation 3: Measurement and Management of Credit Exposures: ‘Alternative pricing tools that are used when market prices become temporarily unavailable should be thoroughly tested, be understood by all participants and generate results in a timely manner.’*

**Comments:** While CCPs cannot ensure such understanding, CCPs may be obliged to demonstrate that they have taken steps to promote such understanding among its participants.

*Guidance 3.3: ‘a CCP might have limits on the degree of concentration that a participant may reach. It may also address the concentration risk through additional or escalating margin requirements or it may use other techniques.’*

**Comments:** If the instruments in question are subject to ‘mandatory’ clearing, setting concentration risk limits might cause problems in some cases.

*Recommendation 4: Margin requirements: ‘Given the potential difficulty in measuring exposures, it is important that the margin methodology, and any material revisions, should be reviewed periodically by a qualified, independent internal group or third party and through rigorous back testing and stress testing of margin requirements.’*

**Comments:** There should be more clarity as to the meanings of ‘independent internal group’ and ‘stress testing of margin requirements’. Stress testing is so far used to assess adequacy of resources with the CCP to meet default in an extreme scenario by the settlement participant on whom the CCP has highest exposure i.e. it was linked to adequacy of resources and not to assess adequacy of margin requirements. Hence, the reference to Stress Test may be removed to avoid any confusion.

*‘As correlations among complex financial products could become unstable in unanticipated ways in times of market stress, continual review of product correlations is particularly important for an OTC derivatives CCP that uses portfolio margining across different products.’*

**Comments:** Only looking at ‘correlations’ may not be sufficient. Other aspects like market liquidity, concentration of positions are also important in this context.

*‘Clear disclosure to its participants about the scale of portfolio margining and the method used is highly beneficial.’*

**Comments:** CCPs are in favour of such disclosure to its participants.

*Recommendation 5: Financial Resources: ‘When an OTC derivatives CCP defines or changes the way each participant contributes to its financial resources and the way those resources are used, it needs to consider the potential impact on the incentives of participants to manage their own risk.’*

**Comments:** The point here is presumably to be as clear as possible over the extent of mutualisation of risk, i.e. how far there is a ‘defaulter-pays’ as opposed to ‘survivors-pay’, and the impact on moral hazard & participants’ incentives to ensure the CCP manages its risk (& therefore their risks) as well as to ensure they manage their own risks. If it is so, more clarity would be desirable.

*Guidance 5.2 Footnote 11: ‘Alternatively, a CCP may establish a new (affiliated) central counterparty for clearing an OTC derivatives product as a separate legal entity.’*

**Comments:** This approach moves rather than solves certain issues and the degree of affiliation may preserve some mutualisation of risk.

*Recommendation 6: Default Procedures: ‘In managing the portfolio of a defaulting participant, an OTC derivatives CCP may need to enter into trades that hedge the individual positions within the portfolio or enter into a macro-hedge that attempts to manage the risk of an entire portfolio. In such a situation, a CCP may need to consider its ability and the timeframe required to obtain individual hedges; the cost of obtaining those hedges; and its ability and the associated cost to actively manage the associated risks (including basis risk) of the hedging strategy.’*

**Comments:** The management of a defaulting participants’ portfolio will depend on a number of factors – e.g. product characteristics, size and direction of the position – and applies to all asset classes, for example portfolios of listed derivatives where there are multiple maturities/option classes. We therefore feel that the Guidelines should not be too prescriptive on these points. There are a number of different mechanisms which can be used in order to manage the risks of an OTC portfolio in the event of default of which ‘macro hedging’ is only one example. Moreover, ‘macro hedging’ is not an established practice in some markets and is not necessarily seen as the best approach in those markets.

*‘For certain OTC derivatives products that require considerable trading expertise, a CCP may need to make ex ante arrangements to ensure that it has sufficient trading staff with proper risk management expertise.’*

**Comments:** It should be clear that the CCP has access to trading staff, rather than having it ‘in house’.

*Recommendation 8: Operational Risk: 'If an existing CCP expands its clearing services to new products, the CCP should ensure that it has sufficient system capacity. It should evaluate the potential growth of such products and adjust its capacity planning metrics accordingly'*

**Comments:** This is more pertinent in case of products mandated for clearing by regulator.

*Recommendation 9: Money Settlement*

**Comments:** Some of the CCPs feel that it is desirable that the guidance stresses the desirability of settlement in Central Bank money to reduce exposure on private settlement banks and also stresses the beneficial role that collateralized liquidity from Central Bank can play in facilitating such settlement.

*Recommendation 12: Efficiency: 'In OTC derivatives markets, where trading could occur over multiple venues, it is important for a CCP to conduct a thorough and regular analysis of risks, costs and benefits from accepting and clearing trades that are executed or processed at different venues.'*

**Comments:** This seems to discourage the provision of services to multiple trading venues. It could be phrased more positively, e.g. to state that CCPs should design their clearing services to make them scalable to serve multiple venues; while recognising the need to be able to manage risks/resources.

*Guidance 12.3: 'CCP[s] should have in place mechanisms to analyse the cost and operational reliability of clearing an OTC derivative asset class or a product within a particular asset class. Such analysis would include potential netting effects, potential reduction of systemic risk and potential cost (such as potential level of margins and clearing fund contributions, and operational cost) associated with the risk management arrangements that will be needed to address the risks specific to a particular OTC derivatives product that the CCP considers clearing'.*

**Comments:** CCPs should certainly be able to give some indications of margin and fund amounts to enable participants to calculate their own costs, but may not have enough information to make those calculations for firms, which would include for example potential regulatory capital savings and funding costs.

*Recommendation 13: Governance: 'Market governance arrangements should evolve in such a way that reflects the role of CCPs.'*

**Comments:** 'Market governance arrangements would not be under the CCPs' control. Support from Regulators and other authorities would be required to make this happen.

*Guidance 13.4* ‘When the relevant market committee has made a determination but a CCP seeks to deviate from it, the CCP should take a careful decision-making procedure (eg more demanding voting procedure).’

**Comments:** The words “more demanding voting procedure” may be clarified. As stated during the earlier round of consultation, in order to provide the necessary confidence to participants and to maintain market integrity, CCPs would normally respect, but not necessarily be bound by, market norms, conventions and, where relevant, governance arrangements. In doing so, CCPs would also undertake appropriate, comprehensive analysis and ensure that their risk and default management powers and processes are robust enough to withstand the effects of any reasonably predictable decisions by market bodies.

Furthermore, legislation should provide sufficient clarity and certainty for CCPs preferential rights related to participant insolvency and/or default handling to prevail and should remain free from any form of legal or regulatory interference.

On this subject, some of the CCPs are also of the view that for ensuring adequate safety to the market, user owned CCPs should ensure that ownership and management of the CCP are completely segregated and that the CCP should have widely dispersed ownership with adequate representation of independent directors in the Board.

*Recommendation 14: Transparency:* ‘An OTC derivatives CCP should contribute to enhancing market transparency by making market data available to relevant authorities and the public in line with their respective information needs.’

**Comments:** This is acceptable in principle, but there should be clarity on how the public’s ‘needs’ are to be determined.

*‘Common standards should be used for data representation and delivery in order to support proper aggregation of the data and consistent analysis across reporting CCPs.’*

**Comments:** It would be desirable to have common standards across CCPs, Trade Repositories & exchanges.

*Guidance 14.2* ‘If an OTC derivatives CCP clears multiple products (including products that are not OTC derivatives products), the fee structure for such clearing services should be transparent so that current and prospective users can assess and compare costs easily and make informed choices.’

**Comments:** This would be relevant wherever there is the potential for choice, either on whether to clear or where there is a choice of clearing.

**Recommendation 15: Regulation and oversight**

No comments

## **Comments on Annexes**

### **Annex 1: General considerations for clearing OTC derivatives products**

#### *1. Standardization of the product*

**Comments:** This section may be drafted more broadly to consider the operational processes, including a measure of operational processes in addition to merely electronic confirmation.

### **Annex 2.1: The appropriate scope of CCPs' ability to take extraordinary emergency actions**

*'governance arrangements are particularly important because the interests in relation to risk management of a CCP's owners, its managers, its participants, the exchanges and trading platform it serves, and the public are different and may conflict. To ensure that such conflicts do not undermine the effectiveness of a CCP's risk management, it is essential that those responsible for this aspect of a CCP's business have sufficient independence to perform their role effectively.'*

**Comments:** It is an existing provision of RCCP 2004. The meaning appears to be that those within the CCP who are responsible for risk management, while dealing with an extraordinary emergency situation, should not be unduly influenced by the participants, exchanges / TPs, its owners or the public. It is also believed that unless Risk Management has representation in the board, independence of risk management function can get under-mined.

*'It is a common practice for CCPs to have the ability to invoke, in extreme situations, emergency powers that temporarily provide relief to the CCP of obligations to perform on a contract or compensate participants for losses incurred from the failure to perform. Such invocation of emergency powers usually includes circumstances beyond the CCP's reasonable control such as force majeure situations, physical emergencies and extraordinary market events (e.g. complete and prolonged failure of price discovery mechanisms in the market) that may impair orderly operations of a CCP. This is in contrast to taking actions due to credit concerns or to manage economic outcomes, which are typically managed as part of the CCP's regular risk management processes.'*

**Comments:** The words 'manage economic outcomes' needs clarity.

*'Since CCPs must maintain balanced positions and be profit neutral, they should mandate or otherwise mediate the transfer of any windfall directly acquired as a result of their decision from the beneficiaries to the losers of the decision.'*

**Comments:** It will be difficult to determine under what circumstances profits can be treated as having accrued to participants as a result of the CCP's actions. Unless there is clarity on this aspect, such a provision may lead to avoidable disputes.

CCPs should certainly make a full disclosure to their supervisors and participants of their emergency actions taken.

### **Annex 3: Classifying market transparency data**

No comments

## **Issues which are also applicable to other than OTC Derivatives CCPs**

### **Section 3**

The recommendations listed below are also applicable to CCPs who do not clear OTC Derivatives. The proposed measures might in some cases lead to need for CCPs to introduce new procedures/ processes. While CCPs are willing to take necessary actions in this regard, it may need due support from regulators and other supervisors. In some cases like segregation of customer assets, more critically in the cross border context, additional legal enactments will be required to bring in the desired level of comfort. The document should highlight this aspect.

*Para 2(f) : ‘an OTC derivatives CCP may ... need to consider the use of bespoke participation requirements, the segregation and portability of indirect participants’ positions and margins, and how it can incorporate these varied participants into its governance structure.’*

### **Section 2**

*Recommendation 3: Measurement and Management of Credit Exposures: ‘Certain risks of OTC derivatives products may only manifest themselves during stressed market conditions and may be amplified due to a correlation among risk factors. Consequently, an OTC derivatives CCP should ensure that it has the appropriate expertise to understand fully the characteristics of its cleared products and to effectively measure and manage credit exposures.’*

*Guidance 4.1: Margin Requirements: ‘An OTC derivatives CCP with participants in a range of time zones may need to consider the need to adjust its procedures for margining (including the times at which it makes margin calls) taking into account the liquidity of a participant’s local funding market and the operating hours of relevant payment and settlement systems.’*

*‘An OTC derivatives CCP should regularly review whether its stress testing methodology is adequate in light of the above and similar factors and refine it as appropriate.’*

*Guidance 6.3: Default Handling: ‘an OTC derivatives CCP should analyse the effect that different options for handling a participant’s default could have on the market, for example, possible effects on prices as a result of liquidating or hedging open positions of the defaulting participant or as a result of liquidating its collateral’*

*Recommendation 8: Operational Risk: ‘If an OTC derivatives CCP establishes links with multiple venues to accept trades for clearing or starts to clear global OTC derivatives products, potential impacts on its capacity and scalability should be assessed and regularly reviewed.’*

*Recommendation 12: Efficiency: ‘As the scope of products that an OTC derivatives CCP clears may have important implications for how cost-effective it is for its participants (including indirect participants) to clear OTC derivatives products, an OTC derivatives CCP should have in place mechanisms to analyse the cost and operational reliability of clearing an OTC derivatives product.’*

*Recommendation 13: Governance: ‘Participants in OTC derivatives CCPs are likely to be less homogeneous with greater direct or indirect participation by buy-side firms and non-domestic institutions.’*

*Guidance 13.3 ‘an OTC derivatives CCP should have effective governance arrangements for determining the products to be cleared and acceptance of new types of participants. Consideration should be given to the risks that are specific to new types of assets and products or participants because the expansion of its activities to them could have implications for a wide range of aspects of the CCP’s risk management design (e.g. auctions, default procedures, single or multiple clearing funds)’*

## **C. CCP12 Comments on Considerations for Trade Repositories in OTC derivatives markets**

CCP 12 members were in general agreement with the issues flagged in the Report. Many of the CCPs had raised doubts about the efficacy of mandating a single global repository per asset class from the point of view of practical and legal difficulties. Those members were therefore relieved to see that there was no recommendation that the CCP-cleared OTC derivatives would need to be reported to trade repositories.

## **D. Conclusion**

We hope that you have found these comments useful and remain at your disposal for further discussion.

For any further details or clarifications, please contact:

Marcus Zickwolff  
CCP12-Chair  
[marcus.zickwolff@eurexchange.com](mailto:marcus.zickwolff@eurexchange.com)

Siddhartha Roy  
CCP12-Vice-Chair  
[sroy@ccilindia.co.in](mailto:sroy@ccilindia.co.in)

\*\*\*\*\* \*\*\*\*\*