

Via email (fsb@fsb.org)

7 September 2018

Financial Stability Board  
Bank for International Settlements  
CH-4002 Basel, Switzerland

***RE: Incentives to centrally clear over-the-counter derivatives: A post-implementation evaluation of the effects of the G20 financial regulatory reforms***

The Global Association of Central Counterparties (“CCP12”) welcomes the opportunity to provide its response on behalf of our membership to the Derivatives Assessment Team’s (“DAT”), a group convened by the Financial Stability Board (“FSB”), the Basel Committee on Banking Supervision (“BCBS”), the Committee on Payments and Market Infrastructures (“CPMI”), and the International Organization of Securities Commissions (“IOSCO”), together the standard-setting bodies (“SSBs”), consultative document *“Incentives to centrally clear over-the-counter (“OTC”) derivatives: A post-implementation evaluation of the effects of the G20 financial regulatory reforms”* (the “report”).

CCP12 is a global association of 36 members who operate more than 50 individual central counterparties (CCPs) globally across the Americas, EMEA and the Asia-Pacific region. CCP12 aims to promote effective, practical and appropriate risk management and operational standards for CCPs to ensure the safety and efficiency of the financial markets it represents. CCP12 leads and assesses global regulatory and industry initiatives that concern CCPs to form consensus views and seeks to actively engage with regulatory agencies and industry constituents through consultation responses, forum discussions and position papers. Collectively, CCP12 members hold over half a trillion US dollars of initial margin to safeguard the markets we support. As providers of central clearing services, members of CCP12 are directly and indirectly impacted by the G20 reforms set out by the SSBs and analyzed by the DAT in this report.

The report represents one of the most comprehensive and informative analysis on various types of incentives to centrally clear from each of the key clearing stakeholders. We believe that the analysis within the report, as commissioned by the SSBs, is incredibly important to determine whether the regulatory framework, across all primary types of standard setters, individually, and collectively, is meeting the objectives established by the G20. The report illustrates and reinforces many important conclusions that we believe should guide current and future regulatory policy initiatives.

**CCP12 would like to specifically highlight the following primary themes of our response to the report:**

1. **Urgent need to re-calibrate the leverage ratio to recognize the central clearing market structure** related to the provision of client-clearing by clearing service providers. We believe that the analysis detailed in the report further substantiates industry feedback from all key stakeholders and is consistent with the BCBS recognition of the issue in their December 2017 publication *Basel III: Finalising post-crisis reforms (the “BCBS Report”)*.

CCP12 has consistently advocated that the Basel III Leverage Ratio must accommodate the centrally cleared market and regulatory structure in order to meet the G20 objectives since the guidance was originally proposed by the BCBS in June 2013.<sup>1</sup>

2. **Establish an action plan to detail next steps being considered by the SSBs on important challenges related to incentives to clear** which have been analysed within the report. Similar to how the SSBs provided the CCP Work plan for regulatory policy initiatives that are in progress, we would be grateful if the SSBs outline potential next steps for each major challenge related to incentives to clear that has been identified.

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<sup>1</sup> CCP12 Response to BCBS 251 Consultative Document; September 2013, <https://www.bis.org/publ/bcbs251/gaocc.pdf>

3. **Importance to continue the periodic DAT analysis as other financial market reforms which impact incentives to clear continue adoption and begin to mature** (e.g., uncleared margin rules (“UMR”)) and expand beyond just OTC derivatives to other markets and asset classes which have been impacted by the G20 reforms even when not directly intended; specifically, for example, exchange-traded derivatives (“ETD”) and cash securities. In addition, the analysis could capture changes in trading and hedging behaviors as well as externalities specific to clearing (e.g., central bank access, impact to funding liquidity).

We believe that the report is informative not only to the SSBs but also the broader industry when assessing the quantitative and qualitative impact of G20 reforms on incentives to clear that could not be otherwise comprehensively produced as no other single supervisor or industry body maintains access to requisite non-public data to perform such analysis.

CCP12 appreciates the thorough analysis put forth by the DAT in this consultative document. Please find below our comments to the questions presented in the consultative document.

## Section 1: Incentives

1. Do you agree or disagree with the finding that, in general, there are strong incentives for dealers and larger (in terms of level of derivatives activity) clients to centrally clear OTC derivatives? Do you agree or disagree with the finding that some categories of clients have less strong incentives to use central clearing?

CCP12 agrees that incentives to clear exist for most participants, primarily dealers and large clients, however there are categories of customers and jurisdictions where the incentives do not exist or are less pronounced. The DAT study confirms that clients would like access to the counterparty credit risk management benefits of central clearing, but access to those services is limited or inhibited today because of shortcomings in certain regulations. For example, even where client participants are incentivized (or mandated), they are effectively limited or even without access given the limited capacity of client clearing service providers – this is a direct consequence to shortcomings in the regulatory reforms that have been left unaddressed despite overwhelming feedback provided by all key stakeholders.

Barriers to access central clearing have been created by certain reforms, such as the Basel III Leverage Ratio capital requirements and Global Systemically Important Bank (“G-SIB”) capital surcharges for providing client clearing services. In both regulations, the amount of capital required to provide access to central clearing is demonstrably excessive, not in principle, but due to the failure of the corresponding methodologies to appropriately reflect the central clearing market structure in capital reforms that are designed for the bilateral market. This has also been noted by the DAT in sections F5 and F6 of the report.

### *Impact of uncleared margin rules*

The report confirms the importance of UMR on the incentives to clear, which is a vitally important topic because the phase-in of UMR is still being implemented in many jurisdictions. UMR was carefully calibrated to bring risk management best practices into the non-centrally cleared derivatives markets, thus it is important that those reforms are implemented with an appropriate scope. Figure D1 in the report clearly identifies UMR as the primary incentive to centrally clear derivatives, and in Figure D13 it is obvious that without initial margin (“IM”) requirements for non-centrally cleared derivatives, there would be an absence of incentives to clear for many participants (notwithstanding legal mandates implemented by the SSBs). Monitoring UMR must be an ongoing topic for the DAT, both to ensure the level of margins required continue to be appropriate and to ensure that the appropriate derivative products are subject to UMR. As evidenced in the survey responses, several clients have reported difficulty with access to central clearing, however those clients should still have access to risk management best practices as provided by UMR even when such access is not feasible or effectively prohibited.

### *Impact to other cleared markets*

The report evaluates how the G20 reforms have impacted incentives in the OTC derivatives markets, however it is important to recognize that the market for OTC derivatives is just one of the financial markets impacted by these reforms. CCP12 members clear a wide range products beyond just OTC derivatives and we remain concerned about the second order effects that the G20 reforms have had to such markets. We specifically raise attention to the ETD markets and securities markets which are inherently connected to OTC derivatives markets (e.g., each market provides access to risk mitigation for the same underlying risks). While the G20 reforms have been calibrated to the OTC derivatives markets, they've been applied without differentiation to the different market structure of the ETD and securities markets. As we further expand upon within, this has in some instances resulted in second order effects and negative unintended consequences that have impacted incentives for participation in these markets.

2. Do you agree or disagree with the finding that relevant post-crisis reforms have, overall, contributed to the incentives to centrally clear? Is the consultative report's characterisation of distinctions in how the reforms have affected incentives for different types of clients consistent or inconsistent with your experience?

CCP12 acknowledges that the G20 reforms have impacted the incentives to clear OTC derivatives as well as participation in ETD and securities markets. For OTC derivatives, incentives to centrally clear have been positively impacted by the phase-in of UMR and other reforms, such as the BCBS reforms on bank capital requirements for cleared exposures. However, for ETD and securities markets, CCP12 would encourage the DAT to include an assessment of the negative impacts and incentives the reforms have had on these markets.

An example of the negative impact on ETD and equity derivatives markets is illustrated through the application of the Basel III standardized capital models – both the Current Exposure Method (“CEM”) and the Standardized Approach for measuring Counterparty Credit Risk (“SA-CCR”) – without proper recognition of the cleared market structure.

The deficiency of CEM is well documented,<sup>2</sup> a few examples:

- Lack of delta-adjustment for options products
- Fixed limits on recognition of position netting
- Minimum margin period of risk (“MPOR”) higher than the levels commonly recommended by the domestic securities and markets regulators for the products, many of whom are members of CPMI-IOSCO

The deficiency of SA-CCR (which will replace the CEM for certain capital measurements) has also been well documented, a few examples:

- Lack of duration adjustment for commodity products
- Punitive approach towards the recognition of collecting initial margin<sup>3</sup>
- Minimum MPOR higher than the levels commonly recommended by the domestic securities and markets regulators for the products, many of whom are members of CPMI-IOSCO

We believe that it is important that the DAT and SSBs take a holistic view of the financial markets when evaluating the impact of the G20 reforms.

<sup>2</sup> Assessing the Impact of the Basel III Leverage Ratio on the Competitive Landscape of US Derivatives Markets: Evidence from Options\* (Richard Haynes, Lihong McPhail, Haoxiang Zhu), June 2018. *“Using daily data on the customer and house positions of clearing members from Feb. 2013 to Jan. 2018, we confirm that the market share of clearing intermediation has shifted from firms subject to higher leverage requirements to those subject to lower requirements.”* [https://www.cftc.gov/sites/default/files/About/Economic%20Analysis/occe\\_leverage\\_and\\_options.pdf](https://www.cftc.gov/sites/default/files/About/Economic%20Analysis/occe_leverage_and_options.pdf)

<sup>3</sup> An Empirical Analysis of Initial Margin and the SA-CCR (Michael Roberson), July 2018. *“The average residual exposure of 26% effectively treats the clearinghouse 99.7% value-at-risk or expected shortfall measure as if it were an 89% value-at-risk.”* <https://www.cftc.gov/sites/default/files/2018-07/SA-CCRPaper0718.pdf>

3. Do the margin requirements for uncleared derivatives give a sufficient incentive to clear? How do these requirements interact with mandatory clearing obligations to incentivise clearing? Are there particular instruments, and specific types of entities where the incentive to clear is not adequate? In such cases, are there specific aspects of the requirements that diminish incentives to clear?

Figure D13 highlights the importance that UMR adoption will have on incentives to clear, confirming that absent full adoption the incentives to clear are materially less pronounced. UMR enhances the resiliency of the bilateral derivatives markets and therefore systemic risk more broadly; the SSBs should continue to monitor implementation of UMR (in jurisdictions and for products that it has been deemed appropriate). Beyond UMR, it is also important to mention that participants are also evaluating more thoroughly whether standardized, liquid and transparent products better suit their needs when considering capital requirements for non-cleared exposures.

The report confirms views that incentives to clear are largely dependent on a number of factors, with some seeing strong incentive, some to varying degrees, and some with no incentives to clear. Regarding the analysis of the impact of credit support annexes (“CSA”), the report should be clearer on the counterparty and systemic risk implications of the different models, in particular the case where entities do not exchange IM. Often the report comments on the “costs” of central clearing without due recognition of the benefits; for example, how daily exchange of IM and variation margin (“VM”) further reduces systemic risk to the broader financial system and real economy. Price transparency is another example of a benefit relative to the “costs” of central clearing, and CCP12 members are encouraged by the emerging research highlighting the pricing benefits beginning to emerge in the cleared markets as a result of the risk management benefits and the ability to transact with a greater pool of participants.<sup>4</sup> Ultimately, the risk reduction benefits of adopting IM and VM should continue to be positively reinforced even where it may result in increased costs – not least if to consider how such practices may have reduced the impact of the 2008 Financial Crisis. The risks to the broader financial system of not collecting IM and VM were exposed during the 2008 Financial Crisis, and so it is important to not lose sight of the benefits which accrue to economy from the costs of these risk management best practices.

4. The consultative report seeks to identify the most important regulatory and non-regulatory factors which affect incentives to centrally clear OTC derivatives for dealers, other financial intermediaries, large clients and small clients. Please identify any significant missing factors and comment on the relative strength of regulatory and non-regulatory factors discussed in the consultative report.

ETD markets, OTC derivatives markets, and securities markets are linked in many ways, such that any changes to one market will inevitably impact the others. Therefore, the scope of the report would be well informed by including commentary explaining what the feedback has been from other impacted markets as a result of the G20 reforms to the OTC derivatives markets, and potentially conducting further study in this area as part of a next DAT assessment.

The SSBs should also consider how cross-border, geographical, and regulatory deference mechanisms may be impacting the proliferation of central clearing by limiting or constraining access despite regulatory objectives that seek regulatory deference. The G20 took into account the need to adapt supervisory activities to the global nature of OTC derivatives markets. This directive has promoted cross-border arrangements between jurisdictions to enhance financial stability and reduce systemic risk in the derivatives market. Regulators and governments have emphasized the importance and benefit to consider deference mechanisms, as agreed by the G20 Leaders, ‘*We agree that jurisdictions and regulators should be able to defer to each other when it is justified by the quality of their respective regulatory and enforcement regimes, based on similar outcomes, in a non-discriminatory way, paying due respect to home country regulatory regimes.*’<sup>5</sup> We believe that continued support of this objective is fundamental – not least because the nature of the derivatives market is global – to ensuring the success of G20 commitments and corresponding reforms to facilitate access to clearing on a global scale. Given the feedback in the report that certain clients are finding it challenging to access

<sup>4</sup> Bank of England, Staff Working Paper No. 751; OTC Premia; <https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2018/otc-premia.pdf>

<sup>5</sup> G20 Leaders’ St Petersburg Declaration of September 2013 (paragraph 71), [https://www.g20.org/sites/default/files/media/g20\\_leaders\\_declaration\\_st.\\_petersburg\\_summit.pdf](https://www.g20.org/sites/default/files/media/g20_leaders_declaration_st._petersburg_summit.pdf)

client clearing services for OTC derivatives, more attention should be given to how regulatory deference to offshore clearing service providers could help address such challenge.

## Section 2: Markets

5. Is the consultative report's characterisation of the shift of activity and trading liquidity towards centrally cleared products, and the consequent impact on uncleared products, consistent or inconsistent with your experience?

CCP12 members typically observe that liquidity builds where market participants can transact with greatest cost efficiency and market transparency, but also with increasing attention to where jurisdictional forces may incentivize them to trade or clear. In terms of cost efficiency, such as bid/ask spread and margin requirements and funding costs, the G20 reforms have directly changed the economic analysis for all key stakeholders for determining cost efficiency in the financial markets.

The report largely confirms that liquidity for more standardized OTC derivatives is at CCPs. This is direct reflection of where the greatest cost efficiency can be realized by market participants. Figure D3 in the report highlights the important considerations clients weigh when determining to clear a non-mandated OTC derivative, and each item in the table can be attributed to cost efficiency in some form either directly or indirectly. Recent Bank for International Settlements ("BIS") statistics estimate the gross credit exposure in the OTC derivatives markets is \$2.7 trillion dollars as of December 2017.<sup>6</sup> This confirms the importance of ensuring that G20 reforms are appropriately calibrated as they will directly impact incentives shaping future market structure and the SSBs should be mindful of this when monitoring the application of their regulations.

6. There are various industry efforts underway to reduce the cost of clearing, including portfolio compression and direct clearing membership models. Based on your experience are these proposals, or other forthcoming changes to clearing infrastructure and models, likely to affect incentives to provide or use clearing services?

Industry efforts such as portfolio compression, direct clearing membership, and sponsor membership models are important initiatives led by the industry that will increase the efficiency of existing cleared markets; however, they alone will not provide the level of relief needed to increase access to central clearing services, particularly for smaller clients that may desire to access cleared markets. The most effective way to increase access for these types of clients is to address the disincentives to clearing service providers via the Basel III Leverage Ratio, specifically by providing an initial margin offset for client cleared derivatives. Refer to the CCP12 letter to the BCBS in July 2016 for further detail.<sup>7</sup>

The SSBs need to take this report as a call for action to address the deficiencies in the Basel III Leverage Ratio calibration as a priority while also considering how other G20 reforms may be resulting in unintended consequences which are now emerging.

## Section 3: Reforms

7. Do you agree or disagree with the report's characterisation of the effects of the following reforms on incentives to centrally clear?
- a. central clearing mandates (both in terms of product scope and entity scope);

<sup>6</sup> BIS OTC Derivatives Statistics at end-December 2017, [https://www.bis.org/publ/otc\\_hy1805.htm](https://www.bis.org/publ/otc_hy1805.htm)

<sup>7</sup> <http://ccp12.org/wp-content/uploads/2017/05/CCP12-EACH-Response-Revisions-to-the-Basel-III-LeverageRatioFramework2.pdf>

CCP12 agrees with the report's characterization of the effects provided by central clearing mandates (where they have been deemed appropriate by the SSBs). The product coverage of the clearing mandates has been carefully extended to consider product liquidity and the capabilities of CCPs to manage the relevant risks within their business-as-usual ("BAU") and default management processes. It is important that clearing mandates are broadly consistent and exemptions limited. For example, we believe that more consistency is needed in some credit derivatives where the clearing mandate is broader in the US than it is in EU (or other jurisdictions).

b. minimum standards for margin requirements for uncleared derivatives;

CCP12 agrees with the report's characterization of the effects provided by minimum standards for margin requirements for uncleared derivatives (commonly referred to as UMR). The survey rightly highlights that there is a need to continue the rollout of UMR (where it has been deemed appropriate) to ensure that regulatory incentives to centrally clear are properly installed. As UMR implementation matures, and products subject to those reforms potentially become more standardized, it will become important that the SSB's monitor the broader financial markets to ensure the incentives to clear continue as originally intended.

c. capital requirements for credit valuation adjustment (CVA) risk;

CCP12 agrees with the report's characterization of the effects provided by CVA.

d. capital requirements for jump-to-default risk (including where applicable the Standardised approach for counterparty credit risk (SA-CCR) and the Current exposure method (CEM));

CCP12 broadly agrees however the application of both CEM and SA-CCR on the ETD and equity derivative markets will have profound impact over time because neither model is designed or calibrated for the cleared market structure. Deficiencies in the CEM approach are now well documented,<sup>8</sup> and research is quickly emerging highlighting the need for a further evaluation of the SA-CCR.<sup>9</sup>

CCP12 commented on the SA-CCR consultation (initially proposed as the Non-Internal Model Method) because of the importance the model would have on cleared markets.<sup>10</sup> The SSBs should conduct a thorough re-evaluation of the SA-CCR and consider where adjustments may be required to avoid any unintended consequences.

e. G-SIB requirements; and

CCP12 agrees that the G-SIB capital surcharge requirements impact incentives for a G-SIB to provide central clearing access due to shortcomings in the calibration to recognize cleared market structure.

f. The leverage ratio.

CCP12 disagrees with the report's assessment of the leverage ratio as the report appears to discount the impact through the use of terms such as "may", "could" and "might" despite definitive analysis provided in the report – for example:

- Page 61, These aspects could affect incentives for firms to provide client clearing services, and for clients to centrally clear (as their clearing member bank may increase the price of services in order to offset its leverage ratio capital requirements).

<sup>8</sup> Basel Committee on Banking Supervision, The non-internal model method for capitalising counterparty credit risk exposures, BCBS 254, July 2013, <https://www.bis.org/publ/bcbs254.pdf>

<sup>9</sup> An Empirical Analysis of Initial Margin and the SA-CCR (Michael Roberson), July 2018, <https://www.cftc.gov/sites/default/files/2018-07/SA-CCRPaper0718.pdf>

<sup>10</sup> <https://www.bis.org/publ/bcbs254/ccp12.pdf>



- Page 65, Overall, the information available to the DAT supports the view that the leverage ratio *may* pose some disincentives for certain firms that offer client clearing services, and this *might* translate into higher costs for clients and a reduced availability of clearing services.

CCP12 members believe the evidence in the report is definitive; the Basel III Leverage Ratio has had negative impacts on the incentives to provide access to central clearing that remain unaddressed by the SSBs.

CCP12 has long advocated for changes to the Basel III Leverage Ratio to appropriately account for the central clearing market structure. Our members anxiously await progress in revisions to the Basel III Leverage Ratio in order to provide client clearing service providers and clients greater access to central clearing. It would also help mitigate the potential for incremental systemic risk in the event of a large clearing member default where there may be constraints for a solvent clearing member to accept (or effectively bid in an auction) clients due to constraints in the leverage ratio and/or G-SIB requirements. CCP12's views on this topic are further elaborated in our July 2016 letter to the BCBS during their consultative review of the Basel III Leverage Ratio calibration.<sup>11</sup>

8. Do you agree or disagree with the consultative report's characterisation of the impact of these reforms on the incentives to provide client clearing services?

The report is forthcoming in illustrating the various considerations and perspectives for incentives to clear. It highlights the more commonly discussed negative incentives, however it does not provide any path forward on how the SSBs will address such mutually agreed shortcomings in the G20 reforms. CCP12 members ask that the SSBs commit to addressing the identified deficiencies in the G20 reforms.

9. Are there any areas where potential policy adjustments should be considered which would enhance the incentives for or access to central clearing of OTC derivatives, or the incentives to provide client clearing services?

CCP12 members would prioritize policy adjustments to the Basel III Leverage Ratio. The Basel III Leverage Ratio, and its lack of recognition for appropriately segregated customer margin, acts specifically against the other policy reforms intended to incentivize central clearing.

Additional disincentives to central clearing should also be addressed by the SSBs (and corresponding prudential frameworks) in the following:

- G-SIB capital surcharges should better recognize the cleared market structure and, for example, be clarified to exclude any client central clearing at a Qualifying Central Counterparty ("QCCP")<sup>12</sup>
- SA-CCR improvements should be evaluated to identify potential areas to accommodate central clearing and ETD markets, such as:
  - Improvements in the recognition of initial margin
  - Duration adjustments for all asset classes
  - Allow lower MPOR for ETDs

CCP12 members believe that UMR implementation should continue as proposed while the SSBs advance initiatives to address issues raised in the report. Furthermore, clearing mandates should remain intact or come into force as scheduled, so as to provide certainty to market participants to where they should commit resources. Finally, individual jurisdictions should maintain mechanisms to ensure that the global nature of OTC derivatives are acknowledged. This should include ensuring that access for local clearing members, clients and indirect clients to global OTC markets based

<sup>11</sup> <http://ccp12.org/wp-content/uploads/2017/05/CCP12-EACH-Response-Revisions-to-the-Basel-III-LeverageRatioFramework2.pdf>

<sup>12</sup> See QCCP definition in the BCBS "Capital Requirements for bank exposures to central counterparties", April 2014, <https://www.bis.org/publ/bcbs282.pdf>

on a global regime of deference between jurisdictions is established and is effective in confirming the G20 reforms are not undermined.

#### Section 4: Access

10. Do you agree or disagree with the report's characterisation of the difficulties some clients, especially clients with smaller or more directional derivatives activity, face in:

- a. accessing clearing arrangements; and

CCP12 agrees with the report's characterization of the access constraints observed by smaller clients. This is consistent with client feedback and industry perspectives consistently provided over the last several years.

- b. conducting trading and/or hedging activity given the restrictions imposed by their client clearing service providers?

CCP12 agrees with the report's characterization of these constraints and notes that these are often observed in the ETD and securities markets as well as the OTC markets. CCP12 members have often assisted market participants facing these constraints in finding new avenues to conduct their trading and hedging activity. CCP12 encourages the DAT to expand its assessment into these markets.

11. Do you agree or disagree with the finding that the provision of client clearing services is concentrated in a relatively small number of banks? Does the current level of concentration raise any concerns about incentives to centrally clear, or risks to the continuity of provision of critical economic functions, including during periods of stress?

The data included in the report largely substantiates the conclusion that client clearing services for OTC derivatives is concentrated in a relatively small number of banks. Further, we agree with the report's comments that offering client clearing services is a business with relatively high upfront fixed costs where profitability would appear to depend in part on achieving economies of scale. Where G20 reforms are introducing constraints for banks to provide client clearing, they should be addressed to ensure that they are not inadvertently increasing any barriers to entry that could lead to second order effects to the effectiveness of CCP default management.

It is important to recognize that solvent clearing members play a crucial role in the cleared markets in the event of a clearing member default, specifically their ability and capacity to accept the ported clients of a defaulted clearing member for purposes of continuity of client-cleared portfolios. Where the Basel III Leverage Ratio (and the G-SIB requirements) are not appropriately calibrated to the cleared market, therefore resulting in outsized capital requirements, it is likely to stress or limit entirely the ability of a solvent clearing member to accept client portfolios due to potential capital capacity constraints.

12. Do you agree or disagree with the report's characterisation of the incentive effects created by up-front and ongoing fixed costs of:

- a. using clearing services?

CCP12 members agree that with the characterization in the report.

- b. providing client clearing services?

CCP12 members agree that both up-front and ongoing fixed costs impact the business considerations to provide client clearing services. While the report does mention the social benefits of clearing, it does not provide further context on



how the risk reduction benefits provided by clearing reduce systemic risk through, for example, posting of margin and greater position netting and efficiency. We believe that the report should corroborate that ultimately some costs must exist for access to these risk reducing benefits.

The report should also consider the significant ex-post costs to the financial system when the markets choose not to adopt the risk management best practices of central clearing and UMR. These costs can be viewed from the perspective of non-cleared derivatives markets during the 2008 Financial Crisis, where risks and cost to participants and society materialized only during the crisis event.

13. In light of the finding in this report that economic factors generally incentivise central clearing for certain market participants but perhaps not for others, please describe your views regarding the costs and benefits of the scope of the clearing mandates, both in terms of the products and entities covered.

CCP12 recommends that the G20 reforms evaluated in the report be allowed to fully implement before any decisions are made regarding the scope and application of clearing mandates.

14. Should regulation seek to create incentives to centrally clear OTC derivatives for all financial firms, including the smallest and least active? If so, what would that imply for the costs of uncleared trades? If not, for which types of firm and product is it most important to have incentives for central clearing? Conversely for which types of firm and product would it be acceptable not to have incentives for central clearing? Please elaborate.

The report confirms that there is market demand for central clearing services and recognition of the substantial benefits they provide in terms of risk management, transparency and price discovery. However, access and incentives remain an issue for some market participants. While smaller participants may not pose systemic risk to the financial system, they stand to benefit from efficiencies, and liquidity (not only as takers, but also providers) while further reducing bilateral risk in the financial markets. Increased liquidity and more participants will provide greater stability and efficiency to financial markets, meaning less volatility and greater ease of managing risks during a stressed market. Nevertheless, there could be scenarios where a legal mandate to clear a product (or for certain types of participants) would not be most appropriate which has already been recognized in many jurisdictions.

CCP12 believes it is important to grant exemptions only where risks are immaterial from a financial stability standpoint, there is no demonstrable benefit for clearing services (e.g., transparency, price discovery) or is otherwise deemed not appropriate. The scope of participants subject to clearing obligations should be appropriately defined, with consideration to the size of the relevant market, its liquidity, the potential emergence of price basis between cleared and uncleared (e.g., small financial firms play significant role compared on the CDS market). Besides, one could argue that such exemptions could further disincentivize clearing service providers to offer CCP access to smaller clients willing to clear, which would be contrary to the initial objective.

As evidenced in the report, small financial firms struggle to access clearing services, either directly as clearing members or indirectly as clients of clearing members, to cover risks related to their portfolios. The extent of client clearing offered by clearing members today is not sufficient to meet the market demand of all potential clients and the costs can still be relatively significant for small financials. We believe that one effective way to address such access issues for smaller firms is to ensure that the Basel III Leverage Ratio (and also the G-SIB requirements) are appropriately calibrated to the cleared market, specifically how it accounts for the provision of client clearing. While exemptions from the clearing obligations are at times appropriate, we stress the importance for the SSBs to address the lack of access to clearing by removing barriers to access clearing that are being introduced through the Basel III Leverage Ratio (and also the G-SIB requirements).

We greatly appreciate the opportunity to comment on this consultative document. We appreciate that the SSBs have also found it important to perform a comprehensive assessment of how the G20 reforms have impacted incentives to clear. The report illustrates that while the G20 reforms have been successful in many aspects, there are several important enhancements that are required to fully meet the G20 objectives. CCP12 would be interested to discuss these further and elaborate on any of the comments described in our response.

Sincerely,

**XU Zhen,**  
**Chairman of CCP12**

**Marcus Zickwolff,**  
**CEO of CCP12**