

Market Risk Advisory Committee

CCP Risk Management Subcommittee's Draft Recommendations on Enhancing CCP Coordination in the Default Management Process

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Since its formation, the CRM has been working in parallel with the Default Risk Management Working Group (DRMWG). DRMWG is a voluntary group of eight central counterparty clearinghouse (CCP) operators, representing 15 CCPs whose goal is to improve the CCPs' coordination around default management.¹ MRAC CRM has reviewed a number of initiatives that have come out of the DRMWG's work and CRM endorses the following recommendations:

Recommendations²

1. CCPs should establish and maintain communication channels with other CCPs.

Recommendation Description: Create and maintain a global directory of the CCP decision-makers which will have regular communications both during peace time and market distress. These communication channels should help promote collaborative work among CCPs in their effort to minimize risks and promote efficiency of the financial marketplace. They will also help facilitate information sharing among CCPs during a market crisis.

Current Status: The Default Risk Management Working Group (DRMWG) created a global CCP directory, which contains contact information of decision-makers and risk management personnel. It was also agreed that each CCP will create a dedicated email address for CCP communications.

2. Where applicable, CCPs should coordinate the rotation of seconded traders for default management.

Recommendation Description: CCPs that clear similar products and utilize traders in their default management processes should coordinate the rotation of seconded traders in order to a) fairly balance the trading resource allocation across clearing members and b) avoid requesting multiple traders from a single trading desk. As a corollary, CCPs should strive to coordinate timing and periodicity of the traders' rotations to make them easier and more efficient.

Current Status: The DRMWG decided that it would be best for CCPs to work bilaterally/multilaterally to harmonize rotation of seconded traders. To that end, CME and ICE held extensive discussions and started coordinating the rotation of seconded traders. To facilitate this process, CME aligned its default management rotation to coincide with the beginning of the calendar year for both IRS and CDS. Other CCPs have engaged or will engage in similar arrangements.

¹ DRMWG includes CME Group, Eurex Clearing AG, Intercontinental Exchange, The Depository Trust and Clearing Corporation, The Minneapolis Grain Exchange Clearing House, The Options Clearing Corporation, Nasdaq, and The London Metal Exchange.

² Not all items may be entirely applicable to all CCPs given differences in business models and rules.

3. CCPs should endeavor to conduct simultaneous/joint default management drill exercises with other CCPs that clear a similar or complementary product mix.

Recommendation Description: A default of any large financial institution will have a profound impact on global financial markets and consequently on many CCPs. As such, a coordinated effort across many CCPs will be needed. The best way to test risk management, operational, legal, logistical and technological preparedness with respect to coordination during a market crisis will be for CCPs to organize simultaneous/joint default management drill exercises. These joint drills will help CCPs to uncover and resolve any issues around joint default management processes and procedures. These drills may explore some of the CCP coordination recommendations such as testing communications channels; testing risk management coordination or cooperation; exploring coordination around customer porting; utilizing common trading resources. Finally, these joint drills will test preparedness, in terms of resource allocation and technological capacity, of the clearing members in responding to multiple default management inquiries from various CCPs at the same time.

Current Status: The DRMWG discussed this recommendation and it was decided that CCPs with similar product mix should strive to conduct simultaneous/ joint drills. We are in the process of determining the scope of these joint drills, and it is expected that initial joints drill will be conducted in 2016. Over the years CME Inc. has conducted simultaneous drills with OCC and with CME CE. Currently, CME is planning to do a CDS joint drill with ICE in November. LCH Clearnet and Eurex Clearing conducted a joint drill in February of this year, and so did ICE and OCC in 2015.

4. CCPs should coordinate to standardize auction processes, including auction formats and auction types, and to avoid creation of any structural impediments to the universe of potential auction participants.

Recommendation Description: Prepare a document whose goal will be to improve consistency of terminology and conventions across CCPs, so that the market participants in CCP default management auctions find it easier to understand the rules and conventions of each auction in which they take part. This transparent approach to auction default management will lead to a better understanding of auction rules which in turn will lead to more-effective auctions, since the underlying assumption in auction design is that all bidders behave rationally based on those rules. Establishing common terminology and conventions may also enable improved communications between CCPs during any default management related cooperation and/or coordination. CCPs will adopt the main recommendations presented in this document and use it whenever interacting with their clearing members in relation to default management auctions via face-to-face communications, written communications or system interactions.

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Current Status: On April 1st, 2016, the DRMWG ratified the ***Uniform CCP Terminology for Default Management Auctions*** document. The main goal of this document is to improve consistency of terminology and conventions across CCPs, so that the market participants in CCP default management auctions find it easier to understand the rules and conventions of each auction in which they take part. This document is intended to be public and therefore it is expected that each CCP will share it with its clearing members and other stakeholders.

5. Where possible, CCPs should coordinate the porting of customers.

Recommendation Description: Explore solutions for financial, operational and technological obstacles in the porting of customers. Strive to create standardized approaches which will make customer porting easier. CCPs should include simulations of the porting of customer portfolios in their default management drills.

Recommendation(s): The DRMWG is drafting a document which would identify major regulatory, technological, judicial, and resource obstacles associated with customer porting and offer various tools and solutions which would make the porting process more effective and efficient. The effort has focused on the relevant stakeholders that include Clients, CCP Members, and CCPs, and Regulators. The DRMWG thus far has identified at least three main areas of weakness in the current porting process: (1) standard KYC and AML protocols for onboarding a large number of customers during default is unrealistic given the timelines within which the porting is expected to take place, (2) CCPs oftentimes do not have customer information required for porting or KYC analysis (such as the customer name or address) possibly due to operational/legal/regulatory constraints, and (3) the cost of multi-clearer relationships restricts the ability of smaller customers to have a back-up clearer in case there is a default. Some of the porting solutions may require regulatory actions and harmonization of various porting rules across geographies.