October 23, 2015

Via Email

Mr. Robert Lindley
Deputy Head
CPMI Secretariat
Committee on Payments and Market Infrastructures
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Mr. Verinder Sharma
Policy Advisor
IOSCO General Secretariat
International Organization of Securities Commissions
Calle Oquendo 12
28006 Madrid
Spain

RE: Recommendations on Financial Risk Management of Central Counterparties

Dear Messrs. Lindley and Sharma:

The Asset Management Group ("AMG")[1] of the Securities Industry and Financial Markets Association ("SIFMA") would like to provide the Committee on Payments and Market Infrastructures ("CPMI") and the International Organization of Securities Commissions ("IOSCO") with our recommendations and observations on the *Principles of Financial Market Infrastructures* ("PFMIs")[2] that relate to central counterparties ("CCPs"). AMG's comments are

---

[1] AMG's members represent U.S. asset management firms whose combined assets under management exceed $30 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 pension funds, undertakings for collective investments in transferable securities ("UCITS") and private funds, such as hedge funds and private equity funds.

[2] CPMI (formerly known as the Committee on Payment and Settlement Systems) and the Technical Committee of IOSCO, *Principles for Financial Market Infrastructures* (April 2012), available at:

provided in conjunction with CPMI's and IOSCO's first "Level 3" PFMI Principles Assessment for the PFMIs for Financial Market Infrastructures (FMIs) (the "Level 3 Assessment"), and focus on issues related to CCP resilience, recovery, and resolution.[3]

CCP resilience, recovery, and resolution are of critical importance to AMG's members. Asset managers use derivatives cleared at CCPs for a range of purposes on behalf of their clients, including managing or hedging investment risks (*e.g.*, changes in interest rates, exchange rates, and commodity prices). In making these decisions, asset managers must actively weigh counterparty risks for clients that include pension funds and mutual funds, among others, whose regulatory directives and investor profile require asset managers to protect invested assets, including from the failure of a CCP. Given the time that has passed since the implementation of the G-20 mandates and development of the PFMIs, the Level 3 Assessment provides an important opportunity to build upon and enhance the PFMIs to promote consistency across CCPs for cleared derivatives used by AMG members.

AMG believes that the PFMIs should be enhanced to require a CCP to provide the same type and level of information other market participants have traditionally provided in the bilateral derivatives market—namely, sufficient information to appropriately assess and monitor an entity's financial stability and ability to survive financial stress. AMG members have observed that the implementation of the PFMIs by national regulators and, ultimately, the CCPs to date lack consistency, standardization, and transparency, preventing asset managers from fully assessing CCP resiliency in advance of and during times of financial stress. Further, a lack of standardization and transparency does not allow AMG members to accurately compare CCPs across products and regions. Given the current notional value of cleared derivatives in the U.S. and globally and its expected increase in the near future as G-20 countries continue to mandate clearing, the PFMIs are critical to the financial stability of CCPs and the global financial system.

Specifically, as discussed in more detail below, AMG believes that CCP standards related to risk management, stress testing, planning, and financial safeguards, which are crucial to preparing a CCP to recover from disruptions (where possible), need to be enhanced by CPMI and IOSCO. Transparency related to a CCP's implementation of the standards must also be

---

http://www.bis.org/cpmi/publ/d101.htm. Throughout this letter we provide specific citation to pages in the PFMIs as follows: "PFMI at __."

[3] *See* CPMI and IOSCO Press Release, *CPMI and IOSCO begin first "Level 3" PFMI Principles assessment* (July 9, 2015), available at: http://www.bis.org/press/p150709.htm.

increased for asset managers and others that use the services of CCPs.[4] Enhanced standards and related transparency, in addition to raising minimum standards, will provide the market (and regulators) with needed information that will add confidence in the ability of CCPs to weather a financial storm.

Further, AMG urges CPMI and IOSCO to amend the PFMIs to restrict the use of margin from non-defaulting customers in the recovery of a CCP and to require clear standards on when the default management process is no longer effective and a CCP should be resolved or closed.

A. Market Participants Should Have Minimal Exposure to CCP Disruptions

The clients of AMG's members should have minimal exposure to CCP disruptions, such as the default of a clearing member firm or the failure of a CCP. The PFMIs should make clear that a non-defaulting client's initial and variation margin should never be at risk or used in a CCP disruption.[5] The purpose of margin is to cover changes in the value of a derivative, not to cover disruptions to the CCP.[6] If a CCP is permitted to use a non-defaulting client's margin in a recovery scenario, the purpose of margin is undermined.

---

[4] *See e.g.*, Key Consideration 5, Principle 4 (Credit Risk), PFMI at 37 (stating that "[a] CCP should determine the amount and regularly test the sufficiency of its total financial resources available in the event of a default or multiple defaults in extreme but plausible market conditions through rigorous stress testing.") and Principle 7 (Liquidity Risk), PFMI at 57 (stating that "[a]n FMI should maintain sufficient liquid resources . . . with a high degree of confidence under a wide range of potential stress scenarios that . . . would generate the largest aggregate liquidity obligation for the FMI in extreme but plausible market conditions."); Principle 13 (Participant-Default Rules and Procedures), PFMI at 78; and Principle 23 (Disclosure of Rules, Key Procedures, and Market Data), PFMI at 121.

[5] AMG is aware that in the U.S., pursuant to the "legally segregated operationally commingled" ("LSOC") model for clearing swaps, the use of the collateral of non-defaulting clients is not permitted in the event of clearing firm or other client default. However, the U.S. "futures model" does permit non-defaulting clients' collateral posted for futures transactions to be used by the CCP to mitigate the losses due to a defaulting clearing firm or client. AMG has advocated that the LSOC model should also be used for futures transactions in order to remove the initial margin and variation margin of non-defaulting clients from the recovery equation.

[6] *See* Section 3.4.16 (Mitigating and Managing Credit Risk), Principle 4 (Credit Risk), PFMI at 42 (stating "[f]or example, to control the build-up of current exposures, a CCP should require that open positions be marked to market and that each participant pay funds, typically in the form of variation margin, to cover any loss in its positions' net value at least daily; such a requirement limits the accumulation of current exposures and therefore mitigates potential future exposures.").

If a client's margin is permitted to be used in a recovery, at the first sign of systemic disruption, market participants will quickly seek a return of their collateral through the closeout of positions, thereby placing additional strain on the global financial system. The far-reaching impact of a CCP failure is likely to cascade to other CCPs and clearing firms given the current volume of cleared derivatives in only a limited number of CCPs with the small, frequently overlapping, groups of clearing firms.[7]

In order to minimize exposure to market participants and overall systemic exposure, AMG believes that CPMI and IOSCO must make clear that margin will be used for its intended purpose during the entire lifecycle of a CCP, including during recovery and resolution. All margin, meaning both initial and variation margin, should be taken out of the recovery equation because CCPs are able to deploy other tools and resources in a recovery, including their own capital, the guarantee fund contributions of clearing firms, and assessments to clearing firms.

In addition, a recovery scenario that goes beyond standard margining practices and requires multiple margin calls to market participants on open positions for the purpose of sustaining a faltering CCP should not be permitted. Further, a CCP recovery plan must account for the possibility that during a CCP disruption, some market participants: (i) may rapidly close-out positions to preserve their own (or their client's) financial resources or (ii) may even walk away from their legal obligations to a failing CCP (and clearing firm) in the interest of protecting themselves (or their clients) from potential further financial loss during a CCP failure.

For the reasons stated above, the PFMIs should clearly prohibit the use of initial and variation margin during a CCP disruption and utilize the other loss-absorbing tools and resources available to CCPs.

---

[7] CPMI and IOSCO observe that "[t]he default of a participant (and its affiliates) has the potential to cause severe disruptions to an FMI, its other participants, and the financial markets more broadly." Section 3.4.1, Principle 4 (Credit Risk), PFMI at 38. According to data released by the U.S. Commodity Futures Trading Commission, 72% of the customer funds in segregation for futures contracts is held by 10 out of 73 clearing firms and 74% of the customer funds in segregation for cleared swaps is held by 10 out of 73 clearing firms with 8 clearing firms out of 73 holding the majority of customer funds for both futures and swaps. *See* CFTC Financial Data for FCMs (July 31, 2015) available at: http://www.cftc.gov/MarketReports/FinancialDataforFCMs/index.htm. Separately, CPMI and IOSCO should assess the risk posed by a concentration of risk in a limited number of clearing firms and add or implement enhancements to the PFMIs to address this risk. As part of the Level 3 Assessment, CPMI and IOSCO could request an analysis from each CCP that details the number of clearing firms for the CCP and the customer funds held by each clearing firm, as well as changes to these values over the past five years since the implementation of the G-20 commitments.

B. The PFMIs Should Require Robust, Consistent and Transparent Standards for CCP Risk Management and Stress Testing

Because stress test standards vary and CCP end-users, such as asset managers, do not have full transparency into the stress test scenarios, it is very difficult to ascertain the level of additional financial resources a CCP should have, among other matters. While the PFMIs state that "a CCP should maintain additional financial resources sufficient to cover a wide range of potential stress scenarios involving extreme but plausible market conditions,"[8] and CCPs regularly deploy stress tests pursuant to national regulators' requirements, there is no consistency among CCP stress tests. The current PFMIs provide a reasonable starting point for credit risk management, including stress tests that account for the default of the largest two participants or the largest participant (depending on the CCPs status as a systemically important CCP).[9] However, because CCPs may develop their own stress tests, there is no uniformity to such stress tests. In conjunction with its Level 3 Assessment, AMG believes CPMI and IOSCO have the opportunity to build upon this starting point by mandating a baseline level of standardized stress tests and requiring greater transparency into the stress tests and the results of such tests. Enhanced stress testing and transparency of both the tests and results provides a key incentive for CCPs to be disciplined in their overall risk management.

AMG has provided suggestions below for improving requirements related to stress tests.

The Requirement for Stress Testing

In the effort to standardize stress testing scenarios, AMG believes that CPMI and IOSCO should set forth additional standards as to the appropriate amount of financial resources and the timeframe for the testing of the sufficiency of the financial resources, providing more specific guidance beyond the PFMIs' statement that these standards should be determined by the CCP.[10] AMG discusses this concept further in the section related to financial safeguards below.

---

[8] Section 3.4.19, Principle 4 (Credit Risk), PFMI at 43 (emphasis added).

[9] *See* Principle 4 (Credit Risk), PFMI at 36.

[10] Section 3.4.20, Principle 4 (Credit Risk), PFMI at 44 ("CCP should determine the amount and regularly test the sufficiency of its total financial resources available in the event of a default or multiple defaults in extreme but plausible market conditions through rigorous stress testing.").

Stress Testing Procedures, Results and Decision Makers

AMG recommends that the PFMIs provide further specificity for its requirement that a "CCP should have clear procedures to report the results of its stress tests" and "to use these results to evaluate the adequacy of and adjust its total financial resources."[11] AMG also recommends that these "procedures" are disclosed in summary form to market participants. Current CCP rulebooks provide some of the processes that a CCP follows in stress testing and also in a recovery scenario. However, there needs to be more certainty and clarity with regard to these procedures. While AMG understands a CCP must be permitted to use multiple tools and have the flexibility to choose a given tool in a specific scenario, there needs to be greater transparency as to what exactly is in the CCP toolbox and what the minimum requirements are for the CCP toolbox.

Although the current PFMIs only require the reporting of stress test results to "decision makers at the CCP," AMG recommends disclosure to market participants.[12] The level of public disclosure needs to be balanced with the risk of providing too much or specific information. The public disclosure could take the form of the public disclosures related to bank stress test results.[13] Transparency into the stress testing scenarios (discussed below) are also of critical importance.

Further, AMG believes that the roles and responsibilities of the risk committee "decision makers at the CCP" must be enhanced through the PFMIs. CCPs do not have uniform standards related to risk committees and the participation of market participants on stakeholder committees. The CCP should disclose the risk setting standards of the risk committee, which would include further stress testing disclosures discussed below. Also, standards for stakeholder committees should be enhanced to require participation by a representative of the different customer interests in the industry (*i.e.*, sell-side, buy-side, asset manager, corporate end-user, etc.).[14] The CCP also should be required to consider clearing firm and market participant input

[11] Section 3.4.21, Principle 4 (Credit Risk), PFMI at 44 (emphasis added).

[12] AMG notes that it may be prudent for the stress test results and related public disclosures to be certified by the appropriate committee or decision maker in order to further incentivize CCP discipline.

[13] AMG acknowledges that the level of detail in certain stress test results should be carefully managed. The disclosures should balance the market participant's need for the information in assessing its own risk to the CCP, as well as understanding the overall risk the CCP presents to the financial system. Some disclosures may be permissible in the form of a pass/fail test result, while other disclosures may provide more detail.

[14] AMG notes that the concept of stakeholder participation is referenced in several PFMIs. *See* Section 3.2.18 (Stakeholder Input), Principle 2 (Governance), PFMI at 31 (stating "[a]n FMI's board should

on all material risk matters.[15] Additional input will serve the CCP and the global financial system well, as it would allow an independent perspective to be brought consistently to the CCP to inform risk and other decisions.

Frequency and Validation of Stress Testing

AMG believes the frequency of stress testing set forth in the PFMIs is sufficient, but recommends requiring more frequent analysis of stress-testing scenarios in times of market stress. The PFMIs provide that there should be daily testing "using standard and predetermined parameters and assumptions."[16] In addition, a CCP should "[o]n at least a monthly basis . . . perform a comprehensive and thorough analysis of stress-testing scenarios, models, and underlying parameters and assumptions used to ensure they are appropriate for determining the CCP's required level of default protection in light of current and evolving market conditions."[17] The PFMIs provide that the CCP's risk-management model should be validated at least annually.[18] However, the PFMIs should require shorter intervals for testing and analysis during market stress, defining both the circumstances and the shorter intervals required.

In addition, AMG members believe that the PFMIs should specifically require an independent validation of the stress tests and risk-management models both prior to use and on a semi-annual or annual basis.[19]

---

consider all relevant stakeholders' interests, including those of its direct and indirect participants, in making major decisions, including those relating to the system's design, rules, and overall business strategy."); Section 3.13.7 (Periodic Testing and Review of Default Procedures), Principle 13 (Default Management), PFMI at 80-81 (stating "[a]n FMI should involve its participants and other stakeholders in the testing and review of its default procedures, including any close-out procedures").

[15] AMG supports the recent submission of The ClearingHouse to CPMI and IOSCO, which focuses on recommendations for CCP risk governance and member consultation processes. *See* Letter from Paige E. Pidano, Managing Director and Senior Associate General Counsel, The ClearingHouse Association, L.L.C. to Messrs. Lindley (CPMI) and Sharman (IOSCO) dated September 18, 2015.

[16] Key Consideration 5, Principle 4 (Credit Risk), PFMI at 44.

[17] Key Consideration 5, Principle 4 (Credit Risk), PFMI at 44 (emphasis added).

[18] Key Consideration 5, Principle 4 (Credit Risk), PFMI at 44.

[19] AMG notes that elsewhere in the PFMIs the concept of model validation by an independent party is discussed. *See, e.g.*, Section 3.2.16 (Model Validation), Principle 2 (Governance), PFMI at 30-31.

Stress Testing Scenarios

AMG believes that, while the PFMIs establish a good starting point for stress testing scenarios, CPMI and IOSCO should, in conjunction with the CCPs and industry, develop a set of standardized stress tests. The PFMIs provide that "a CCP should consider a wide range of relevant stress scenarios in terms of both defaulters' positions and possible price changes in liquidation periods."[20] Further, the "[s]cenarios should include relevant peak historic price volatilities, shifts in other market factors such as price determinants and yield curves, multiple defaults over various time horizons, simultaneous pressures in funding and asset markets, and a spectrum of forward-looking stress scenarios in a variety of extreme but plausible market conditions."[21] In terms of "extreme but plausible conditions," the PFMIs state that a CCP should not consider only "a fixed set of conditions, but rather, conditions that evolve."[22]

Although the CCPs would still be required to perform additional stress tests based on their historical and evolving practices so that the overall testing does not become static,[23] the combination of minimum standards in conjunction with a requirement for CCPs to adequately test according to their own unique risk profiles provides a holistic approach to this central risk management function.

AMG members also believe it would be prudent to develop global CCP stress tests that focus on areas where risk from one CCP could cascade to other CCPs or risk from clearing firm overlap could cascade across CCPs. In other words, CCPs should be required to model a scenario that would impact the CCP beyond its own walls, which is consistent with the concept that a CCP disruption would have a far-reaching impact. A global CCP stress test should also account for the simultaneous testing of clearing firm defaults across multiple clearing firms,

[20] Section 3.4.22, Principle 4 (Credit Risk), PFMI at 44.

[21] Section 3.4.22, Principle 4 (Credit Risk), PFMI at 44.

[22] Section 3.4.22, Principle 4 (Credit Risk), PFMI at 44.

[23] Some CCPs have contended that standardized testing leads to rigidity that does not address dynamic market conditions, as well as model risk and is ineffective for diverse markets. Instead, the CCPs contend that principles for stress testing should permit flexibility to allow for changing market conditions, risk management innovation, and diversity of markets. AMG agrees with these contentions, but submits that stress testing should encompass all of the above principles in a holistic manner. The PFMIs could be structured to set forth standardized stress tests that could be updated on an ongoing basis by the national regulators, as well as a requirement for CCPs to develop their own stress tests that address dynamic market conditions.

particularly where clearing firms are members of multiple CCPs. Global CCP stress tests should also take into account the number of CCPs available to clear a given product or asset class, meaning a stress test could focus on specific CCPs that clear the same asset classes.[24] These global CCP stress tests could also be performed collectively on an annual basis.

C. The PFMIs Should Mandate that Financial Safeguards Are Risk-Based, Funded and Transparent

AMG members believe that the CCP's capital commitment to the guarantee fund should be standardized and assessed in a more robust manner.[25] The PFMIs should further define the importance of this financial safeguard and require a greater level of CCP capital (often referred to as "skin-in-the-game") that is commensurate with the risk managed by the CCP.[26]

The CCP's contribution to the guarantee fund must be commensurate with the risk of the CCP's clearing operations and is an important part of the overall default waterfall, which must be robust and commensurate with the risk managed by the CCP. The margin posted by clients is designed to represent the risk that the client brings to the CCP.[27] The clearing firm's guarantee fund contribution is designed to represent the risk the clearing member firm brings (and accepts by virtue of being a clearing member) to the CCP based on its customer base and size. In addition, a CCP's ability to impose additional assessments on a clearing firm is designed to provide an additional financial safeguard in a time of CCP disruption. Likewise, the CCP

[24] AMG notes that in a period of CCP disruption, the ability of a separate CCP to receive positions from the defaulting CCP is limited because there is not yet fungibility among CCPs. However, this metric may assist in assessing the systemic importance of a CCP for a specific product, which would inform the decision to increase margin and guarantee fund contributions.

[25] The guarantee fund forms part of the default waterfall and can also be referred to as the prefunded default arrangement, or "clearing fund." *See* Section 3.6.2 (Margin Requirements), Principle 6 (Margin), PFMI at 51.

[26] As a threshold matter, AMG believes a CCP default waterfall should not include, at any level, the margin of non-defaulting end-users. Non-defaulting end-users should be safeguarded from risks they cannot manage and that they did not create. Notwithstanding this position, AMG does not object to margin levels that reflect the potential future exposure and current exposure, as determined by transparent CCP risk management standards, that a market participant brings to the CCP.

[27] The PFMI state that "[i]nitial margin is used to cover a CCP's potential future exposures, as well as current exposures not covered by variation margin, to each participant with a high degree of confidence." Section 3.4.17, Principle 4 (Credit Risk), PFMI at 42-43. AMG notes that to the extent a CCP has not disclosed its initial margin methodology to market participants, the CCP should be required to disclose such initial margin methodology and assumptions into the methodology.

guarantee fund contribution is the primary (and, in a way, final) line of defense between a CCP disruption that can be contained and a CCP disruption that can begin to cause a cascading effect throughout the global financial markets.

Given the current and growing role that CCPs play in the risk management of derivatives, current CCP guarantee fund contributions are generally insufficient and should be increased. The amount of the increase to the CCP contribution could take the form of a risk-adjusted increase, a percentage of the overall guarantee fund, or a percentage of the largest clearing firm contribution. AMG believes that an adequate CCP contribution to the guarantee fund incentivizes the best and most state-of-the-art risk management practices. The risk management practices related to sizing the guarantee fund should also be reviewed on a regular basis.[28] Although CCPs have recently argued that non-defaulting clearing firm contributions have not been accessed in recent times, the clearing environment has changed and a failure to acknowledge this fact could be catastrophic. Given the systemic importance of CCPs, an increase in the CCP contribution to the guarantee fund is in its own best interest although it should not displace clearing firm contributions and assessments.[29]

AMG believes that the PMFIs can be strengthened by mandating CCP contributions to the guarantee fund (where not already in place) and setting a minimum, risk-based level. The PFMIs should require prefunding of certain financial resources available to the CCP. The PFMIs state that a "CCP <u>typically</u> uses a sequence of prefunded financial resources, often referred to as a 'waterfall,'" and "a CCP should maintain additional financial resources, such as additional collateral <u>or</u> a prefunded default arrangement, to cover a portion of the tail risk."[30] In addition, the PFMIs state that "[a] CCP <u>should</u> cover its current and potential future exposures to each participant fully with a high degree of confidence using margin and <u>other prefunded financial resources</u>" and "a CCP <u>should</u> maintain additional financial resources sufficient to cover a wide range of potential stress scenarios involving extreme but plausible market conditions."[31] These

[28] AMG understands that current CCP practice is to resize the guarantee fund on a monthly or quarterly basis. AMG notes that to the extent the guarantee fund needs to be risk adjusted, any incremental decrease in risk should not automatically work to decrease the overall contributions or size of the guarantee fund.

[29] As to clearing firm contributions, to the extent not already disclosed, additional disclosure to the clearing firms related to their risk limits and parameters at the CCP would also assist in overall risk management and assessment.

[30] Section 3.4.17, Principle 4 (Credit Risk), PFMI at 42 (emphasis added).

[31] Sections 3.4.18 and 3.4.19, Principle 4 (Credit Risk), PFMI at 43. (emphasis added).

standards should be strengthened to require the availability of these financial resources and prefunding.

In addition, clearing firm assessments should be pre-funded and held in escrow accounts or some other vehicle in order for the funds to be readily available. As noted above, if the financial safeguard of the CCP guarantee fund contribution is insufficient, then the clearing firm contributions provide the next line of defense against systemic failure. The PFMIs should specify, however, that the funds of non-defaulting clearing firms should not be accessed until the defaulters' funds and the CCP's funds have been exhausted.

Further, as noted above, AMG members are concerned with the lack of transparency related to the policies and procedures used in establishing the default waterfall, as well as the actual resources available to the CCP in a default scenario.[32] While the PFMIs currently state: "a CCP should document its supporting rationale for, and should have appropriate governance arrangements relating to (*see* Principle 2 on governance), the amount of total financial resources it maintains,"[33] AMG believes this concept needs to be built upon. Specifically, to the extent not already disclosed, CCPs should disclose in detail the totality of resources available for loss absorbency, including a CCP's capital commitment to the guarantee fund and the size of the guarantee fund in the event of a clearing firm default.

These recommendations establish a system that will cover all of the "known" risk factors. If the amount of a guarantee fund contribution can be calculated, there is no policy reason for why the CCP should not have sufficient liquidity and capital to fund its contribution amount. Enhanced "skin-in-the-game" is not in and of itself the only solution and must be viewed in conjunction with enhanced stress testing and the transparency of those stress tests. In short, the PFMIs should be enhanced in all of these areas.

---

[32] AMG notes that the default waterfall does not encompass other losses that can be experienced by the CCP, including losses due to operational disruptions or fraudulent conduct by the CCP, however, the losses incurred in these events may also cascade to the clearing firms and clients. AMG notes that the PFMIs discuss the operational risk inherent in a CCP, however, additional requirements should be put in place, requiring, for example, the existence of insurance policies or the amount of financial resources reserved for operational crises. *See, e.g.*, 3.3.3 (Comprehensive Risk Policies, Procedures, and Controls), Principle 3 (Framework for the comprehensive management of risks), PFMI at 33.

[33] Section 3.4.19, Principle 4 (Credit Risk), PFMI at 43.

D. The PFMIs Should Require Robust and Clear Recovery Measures

AMG's above recommendations for the guarantee fund form the cornerstone of CCPs recovery measures. However, additional CCP recovery measures should be clarified and enhanced. As noted above, AMG members believe that initial margin and variation margin should not be used in the recovery process, as it undermines the purpose of margin. This includes variation margin haircutting.

The PFMIs should require robust information systems that can promptly produce data needed in a recovery and resolution scenario. In a recovery scenario a CCP should have at its disposal the assistance of a diversity of market participants for a portfolio auction. Therefore, AMG recommends that the PFMIs require a CCP to establish clear rules for portfolio auctions in advance of a recovery event that permit the participation of clearing firms, as well as other market participants, specifically those with expertise in the asset classes composing a CCP's portfolio.[34] These efforts will allow a CCP the greatest opportunity to re-establish a matched book and avoid resolution.

E. Resolution Must Be an Option, But Not a Requirement

While the Level 3 Assessment is focused more on resilience and recovery, the topic of resolution should also be considered by CPMI and IOSCO. Given the systemic implications of a CCP failure, recovery of a CCP is preferable to its closure or resolution, but not at any cost. CPMI and IOSCO should establish a clear standard as to when the default management process is no longer effective, referred to as a "Point of Non-Viability" ("PONV"), and a CCP should be resolved or closed.[35]

The PONV should be clearly defined to include the circumstances in which recovery measures are deployed and the maximum time afforded to a CCP for the deployment of such recovery measures. For example, the PONV can be established when there is a failed portfolio auction and the CCP's matched book cannot be re-established.

---

[34] AMG suggests that in times of financial stress where there are multiple defaults, those with industry and market expertise will be in high demand. Therefore, it would be prudent for CCPs to maintain an active list of multiple market experts that it would contact in a default scenario.

[35] AMG recognizes that this clear standard could be a principles-based standard that allows for some measure of flexibility for regulators to determine the PONV and resolve a CCP.

When the recovery measures have failed, there must be an established, clear and rapid process to close out positions (including immediately establishing a "tear up" price) to limit end-user losses and systemic impact. There should be no delay in invoking the resolution process by the CCP and relevant regulator, once a PONV is reached. In short, a clearly defined and rapid liquidation process would permit resolution, that is the close-out of positions and the return of margin to non-defaulting parties, in order for market participants to re-establish positions to manage risk in the cleared derivatives market.

* * * *

For the reasons stated above, AMG urges CPMI and IOSCO to use the Level 3 Assessment as an opportunity to enhance the PFMI CCP standards related to risk management, stress testing, planning, and financial safeguards, which are crucial to preparing a CCP to recover from disruptions. Enhanced PFMI CCP standards will add additional robustness to the global financial system and additional confidence in the ability of CCPs to weather a financial storm.

AMG appreciates CPMI's and IOSCO's consideration of our comments and stand ready to provide any additional information or assistance that CPMI or IOSCO might find useful. Should you have any questions, please do not hesitate to contact Tim Cameron at 202-962-7447 or tcameron@sifma.org or Laura Martin at 212-313-1176 or lmartin@sifma.org.

Respectfully submitted,

Timothy W. Cameron, Esq.
Managing Director
Asset Management Group – Head
Securities Industry and Financial Markets Association

Laura Martin
Managing Director and Associate General Counsel
Asset Management Group
Securities Industry and Financial Markets Association

cc: Robert Wasserman, Chief Counsel, Division of Clearing and Risk, U.S. Commodity Futures Trading Commission

Daniela Russo, Director, General Payments and Market Infrastructure, European Central Bank