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VIA ELECTRONIC SUBMISSION (cpmi@bis.org and consultation-05-2022@iosco.org)
Committee on Payments and Market Infrastructures
Board of the International Organization of Securities Commissions

Re: CPMI and IOSCO *A discussion paper on central counterparty practices to address non-default losses*

The Global Association of Central Counterparties (“CCP12”) is the international association for central counterparties (“CCPs”), representing 40 members who operate over 60 CCPs across the Americas, EMEA, and the Asia-Pacific region.

CCP12 appreciates the opportunity to comment on the Committee on Payments and Market Infrastructures (“CPMI”) and the Board of the International Organization of Securities Commissions’ (“IOSCO”) *A discussion paper on central counterparty practices to address non-default losses*¹ (“the Discussion Paper”). Generally, we believe the Discussion Paper will further enhance the understanding of the nature of non-default losses (“NDLs”) of many stakeholders, including market participants.

Introductory remarks

As a general matter, we would like to first present the main messages of our response. These are as follows:

- CCP12 strongly believes that no additional standards or guidelines for addressing NDLs would be appropriate or needed at this time. CPMI-IOSCO’s *Principles for financial market infrastructures*² (“PFMIs”) already provide a solid foundation of risk management practices, including for NDL-related risks, that have been embedded in the regulatory frameworks in many jurisdictions and drive CCPs practices worldwide. The PFMIs are comprehensive, while not being overly prescriptive in such a manner that could undermine the ability of CCPs to tailor their practices to the unique characteristics of their offerings. Additionally, the CCP survey results presented in the Discussion Paper do not provide evidence for the need for further work in this

¹ CPMI, IOSCO, *A discussion paper on central counterparty practices to address non-default losses* (August 2022), available at [Link](#)

² Committee on Payment and Settlement Systems, Technical Committee of the International Organization of Securities Commissions, *Principles for financial market infrastructures* (April 2012), available at [Link](#)

area. We therefore welcome the CPMI-IOSCO statement in the Discussion Paper that it “is not intended to create additional standards for CCPs beyond those set out in the PFMI.”³

- CCP12 would also like to point out that in addition to the PFMIs, there has also been the Financial Stability Board’s (“FSB”) workstream focused on resolution standards which sit alongside the standards on resilience and recovery established by CPMI-IOSCO. In these workstreams, amongst others, the issues of risks, tools and resources, including those related to NDLs, have been thoroughly explored and discussed. This is particularly the case for the 2014 CCP and FMI specific recovery and resolution reports from both CPMI-IOSCO⁴ and the FSB⁵. The results of the hard work undertaken by the standard-setting bodies (“SSBs”), local authorities, CCPs, and market participants should be recognised.
- We believe that CCPs’ history and past performance, particularly in times of unprecedented stresses, already demonstrate their resilience and ability to effectively manage the risks they face, including NDL-related risks. Having said that, we can appreciate that information sharing and the exchange of views among CCPs on practices relating to NDLs can be beneficial, as is demonstrated by content in the Discussion Paper. This, however, should not be understood to mean that a new set of standards or guidelines is needed. A strong regulatory framework has already been laid with the local implementation of the PFMIs and under such framework, the management of the diverse types of risks that CCPs face can result in a wide range of risk management practices that are tailored to CCPs’ unique characteristics. A more prescriptive approach could be counterproductive and may in fact be harmful.
- While CCP12 believes that existing practices in addressing NDLs are appropriate and effective, we would support efforts to increase the dialogue and information sharing and encourage CPMI-IOSCO to bring together industry participants to share practices through organising workshops or tabletop exercises.
- CCP12 believes that both the CCPs’ and their regulators’ main emphasis in the realm of management of NDL-related risks should continue to be on CCPs’ taking the appropriate preventative measures that mitigate the likelihood of NDLs. CCPs conduct appropriate evaluation (e.g., scenario testing) of the different NDLs they face based on their individual structures and clearing offerings. CCPs use the results of these evaluations/tests to further enhance their capabilities for addressing NDLs, which serves to affirm and enhance CCPs’ operational resilience. NDL-related risks are very different from the risks stemming from a clearing member’s default. As such, any attempt to shift the focus from NDL prevention to the CCPs’ amassing more financial resources to cover NDLs will most likely not help to prevent NDLs, or deal with them effectively. At the same time, requiring a significant amount of additional resources to be set aside by CCPs for NDLs would have a significant negative impact on the incentive structure that underpins the central clearing model. As long as a CCP has processes in place to effectively identify the types of NDLs it faces and has sufficient resources and practices in place to address such NDLs (including liquidity gaps), it is appropriate for the specifics as to what types of resources and practices it uses to address these risks to vary. CCPs have different characteristics and face different risks and therefore the choice of tools and the level of resources should be left

³ Discussion Paper, at p. 6.

⁴ CPMI, IOSCO, Recovery of financial market infrastructures (October 2014), available at [Link](#)

⁵ FSB, Key Attributes of Effective Resolution Regimes for Financial Institutions (October 2014), available at [Link](#)

to CCPs' discretion, as ultimately the losses would still be addressed. Notwithstanding this, as part of a CCPs' practices for addressing NDLS, consistent with Principle 15 (Key Consideration 5) of the PFMLs, CCPs develop recovery plans, which set out the steps that they will take to maintain continuity of its services in the event that such continuity is threatened. Similarly, a CCP's wind-down plan is designed to ensure that a CCP maintains a robust plan for dealing with a wind-down event. These recovery and wind-down plans are subject to regular review and approval as defined in a CCP's governance arrangements and are also shared with and reviewed by the CCP's primary regulators.

- While the Discussion Paper notes that “there is limited common understanding of CCPs' current practices to address NDLS”⁶ as compared to default losses, we believe this is generally driven by the appropriately diverse practices employed by CCPs for addressing NDLS, as well as the unique characteristics of how specific NDL-related risks may present themselves at individual CCPs. It is important to note that this “limited common understanding” is not due to any lack of disclosure by CCPs with respect to NDLS. CCPs currently provide an exceptionally high level of transparency, which is often not the case in other segments of the market. CCPs have had a long-standing practice of publishing their rules and providing detailed insights into these rules and their risk management practices through their public qualitative and quantitative disclosures, which are in line with the CPML-IOSCO's Disclosure framework and Assessment methodology⁷ (“Disclosure Framework”) and Public quantitative disclosure standards⁸. CCPs also provide information via white papers and other materials and tools they make available on their websites and to market participants directly. In addition, CCPs often organise dedicated workshops and ongoing meetings with groups of participants, as well as bilateral exchanges with these participants, to clarify their rules and procedures, and address any members' questions and concerns. Market participants also participate on many CCPs boards, risk committees, and risk working groups where NDL events, particularly those that have the potential for causing material losses, may be discussed.
- We would further like to highlight that we believe it is of the utmost importance that CCPs comply with the PFMLs as implemented in their local jurisdictions, and enforced by their local regulators. Finally, we should also be cautious in labelling certain practices as “inconsistent with the PFML”⁹. For instance, we do not share the Discussion Paper's interpretation that the PFMLs prescribe NDL scenario coverage for a fixed set of risk types (e.g., including custody or legal risk) as a part of a CCP's recovery planning, particularly since such an interpretation does not take into account a CCP's individual risk exposure. We believe such an undifferentiated approach would not be helpful, as CCPs should have the discretion to focus NDL scenarios on the risk types identified as those that could trigger their recovery (after accounting for risk mitigation measures).

⁶ Discussion Paper, at p. 2.

⁷ Committee on Payment and Settlement Systems, Board of the International Organization of Securities Commissions, Principles for financial market infrastructures: Disclosure framework and Assessment methodology (December 2012), available at [Link](#)

⁸ Committee on Payments and Market Infrastructures, Board of the International Organization of Securities Commissions, Public quantitative disclosure standards for central counterparties (February 2015), available at [Link](#); CCP12 Public Quantitative Disclosures, available at [Link](#); CCP12 Perspective on Transparency (November 2021), available at [Link](#)

⁹ Discussion Paper, at p. 6.

Overarching questions

1. Are there areas in the context of CCP NDLs where further guidance under the PFMI might be helpful? If so, what are the potential areas where further guidance might be most helpful?

While we appreciate the ongoing work of international policymakers to support the stability of the broader financial system, we do not believe that further guidance related to CCPs' NDLs is necessary. This is in large part due to the strong framework the PFMI already provide for CCPs' management of NDLs. The PFMI's principles- and outcomes-based approach allows CCPs to appropriately tailor their risk management practices, including with respect to NDLs, to the unique risks they face.

The Discussion Paper rightfully notes that CCPs consider a range of NDL scenarios that may arise relating to general business risk, operational risk, investment risk, custody risk and legal risk, including the failure of a highly interconnected entity, but that scenarios (and corresponding loss quantification) need to reflect the unique risks to a given CCP.¹⁰ We believe that it is crucial that this point be recognized since each CCP faces risks relating to NDLs that are unique to its individual structure and clearing offering. The need for CCPs to tailor how they address NDLs to their individual risks reaffirms the appropriateness of the PFMI, which, among other things, state that a CCP "should have risk-management policies, procedures, and systems that enable it to identify, measure, monitor, and manage the **range of risks that arise** in or are borne by the"¹¹ (emphasis **added**) CCP, which includes NDL-related risks. The many aspects of how CCPs are expected to manage NDL-related risks are addressed in various PFMI principles (e.g., Principle 1, 3, 15, 16, and 17) and how a particular CCP implements these principles is described in its public qualitative PFMI disclosure.

2. Are there any additional points of consideration or practices, in addition to those mentioned in this discussion paper or in the PFMI and existing guidance, that would help CCPs effectively and comprehensively address losses from non-default events? Are there areas that require additional clarity from authorities? If so, what are they?

We believe the Discussion Paper demonstrates that the PFMI consider all crucial facets of addressing NDLs. The Discussion Paper helpfully highlights a number of practices that CCPs currently employ for identifying NDL scenarios, quantifying NDLs, as well as the tools, resources, and practices used to address NDLs. One of the most significant takeaways we drew from the Discussion Paper is the recognition that the risk management practices that CCPs employ for addressing NDLs are diverse and that the assumptions and scenarios CCPs use to quantify potential NDLs are commonly informed by expert judgement given the challenges of modelling losses from low probability, high-impact events with limited historical data. We believe the diversity of these practices and use of expert judgement should be embraced by both CCPs and policymakers to the extent that they are consistent with a given jurisdiction's local implementation of the PFMI, as they allow a CCP to effectively manage its unique risks.

We fear the diversity of these approaches would be greatly circumscribed by granularly defining requirements related to the risk management of NDLs, which would ultimately make CCPs' practices less effective. Even more troublingly, overly prescriptive NDL requirements could lead a CCP to not focus on

¹⁰ *Ibid.*, at p. 7-8.

¹¹ Principles for financial market infrastructures, *op. cit.*, at p. 32.

more material NDL-related risks that are unique to that CCP. As it would be impossible for any policy-maker to be able to identify all the unique NDL-related risks to which a CCP is subject, the necessary flexibility afforded to CCPs by the PFMI to tailor their risk management programs to their unique risks is crucial.

There is one additional measure which could improve CCPs' ability to manage certain NDL-related risks – namely, granting CCPs access to central bank accounts. The current limitation on access prevents many CCPs from having the ability to use one of the most efficient tools for mitigating certain NDL-related risks, such as custody and investment risks. An IMF Working Paper “Central Counterparties: Addressing their Too Important to Fail Nature”¹² enumerates multiple benefits of a CCP access to central bank services, including the reduction of the CCP's dependency on clearing members that provide collateral services¹³. Having access to a central bank account would reduce the risk associated with commercial bank exposure, as well as the risk of assets being lost or mismanaged more generally, which is a common NDL scenario.

We believe that CCPs, which play a crucial role in reducing systemic risk, should have the ability to enjoy the benefits of holding financial resources that they manage at central banks. The resources that may be held include those posted by CCPs' clearing members and clients. Accordingly, the safety provided by central banks would also benefit market participants. As such, access to accounts at central banks could strengthen the resilience of CCPs and the financial markets as a whole. We therefore urge local regulators to enable PFMI-compliant CCPs to have access to central bank accounts.

3. Are there particular challenges that CCPs face in planning for an orderly wind-down in a NDL scenario? Are there means to motivate further progress in orderly wind-down planning?

No CCP12 comments on this question.

4. Would a similar review of practices in the context of NDLs for FMIs other than CCPs be helpful? Would further guidance under the PFMI be helpful in this context?

CCP12 is generally neutral with respect to the suggestion that the NDL-related practices of financial market infrastructures (“FMIs”) other than CCPs be reviewed. Considering a CCPs' unique characteristics, the NDL practices of other FMIs are unlikely to be very relevant to CCPs.

Identifying NDL scenarios, quantifying NDLs and assessing the sufficiency of resources (Section 2)

5. How can a CCP identify potential NDL scenarios comprehensively as well as with an appropriate degree of granularity?

¹² IMF Working Paper, Central Counterparties: Addressing their Too Important to Fail Nature, by Froukelien Wendt (January 2015), available at [Link](#)

¹³ *Ibid.*, at p. 20.

There are a number of methodologies that a CCP can use to identify potential NDL scenarios. The Discussion Paper highlights the fact that some CCPs have frameworks that consider the risks arising from their activities both comprehensively and separately, in line with the nature of the CCP's business, its products and the markets cleared. We also appreciate that the Discussion Paper's recognises that "this helps to ensure that resources and tools to address NDLs are tailored to the specific nature of the risks faced by a CCP"¹⁴. This is the precise reason why we believe the PFMLs and their built-in flexibility provide the appropriate considerations for CCPs' practices as they relate to NDLs. We believe an important aspect of the identification of NDL scenarios is leveraging the expertise of internal subject matter experts as part of the process of determining first which of the scenarios are relevant to the CCP and then which of these scenarios would impact the CCP so significantly that it could enter recovery. For example, this identification process may include first maintaining an inventory of all material NDL-related risk impacts and then estimating the severity of the potential loss that could materialise. The most important aspect of scenario identification is to ensure that the scenarios are appropriate for the individual CCP based on the markets and the products it clears – hence the involvement of experts who can help tailor the scenarios to the CCP's unique risk profile and characteristics. Robust internal governance processes also help to provide for appropriate scenario identification and review.

Along these lines, it is also of the utmost importance that in identifying potential NDL scenarios a CCP considers the *plausibility* of such scenarios occurring relative to its offering and practices. While CCP12 understands why the Discussion Paper highlights the fact that NDL events can be low-probability and high-impact, it is still important that the identification of NDL scenarios focuses on those scenarios that are extreme but plausible. Broadly speaking, implausible scenarios should not be the focus of a CCP's NDL scenario analysis, nor the basis for the assessment of the sufficiency of their tools and resources.

6. Given that a CCP's efforts to prevent losses from non-default events may fail, what are effective approaches to prepare for and address resulting losses, in particular from low-probability, high-impact events?

An effective approach to prepare for and address potential NDL events, particularly low-probability, high-impact events, is for CCPs to regularly assess (e.g., at least annually) the effectiveness of their risk management plans for addressing potential NDLs, including reviewing the potential NDL scenarios, the sizing of the potential losses and how such losses would be managed by the CCP (i.e. tools and resources). Additionally, to the extent that a CCP may use liquidity and credit facilities to manage an NDL event, it should also test these facilities. In evaluating potential NDL scenarios, internal subject matter experts at the CCP would typically run through these scenarios based on the resources and procedures it has in place. CCPs then use the results of these tabletop workshops to determine the sufficiency of their resources and/or tools to address a given NDL event and adjust the resources and tools accordingly.

7. Are approaches such as sensitivity analysis, scenario simulations, drills or stress-testing analysis useful for quantifying resource needs and assessing adequate NDL coverage? If so, what are

¹⁴ Discussion Paper, at p. 7.

potential obstacles hampering progress in this area and what could be possible avenues for reducing those obstacles?

CCP12 agrees that the above-mentioned approaches may be helpful, but these approaches must be tailored to the unique characteristics of the given CCP and its risk profile. This is possible under the PFMI framework. These approaches could be used by CCPs to quantify resource needs and assess NDL coverage for both business as usual and recovery scenarios in a manner appropriate for the unique business model of each CCP.

As described further in the response to Question 11, it is noteworthy how well CCPs have managed NDLS to date, given the lack of internal loss data at CCPs, as well as external loss data for CCPs as an industry. The lack of loss data, in and of itself, demonstrates how effectively CCPs have mitigated NDL-related risks. Given the inherent difficulty of modelling potential losses for extreme but plausible events with limited available data, CCPs also rely on assumptions informed by internal and external expert judgment to identify and quantify potential NDLS. Therefore, we believe that the most effective practice for NDL exposure identification and quantification, at the present time, is to use a combination of both qualitative (i.e., expert judgment) and quantitative approaches. Quantitative approaches may include using data from other financial institutions. It is important to highlight, however, that such data would need to be appropriately adjusted for the unique characteristics and risk profile of a given CCP.

8. Are there particular types of NDL scenario that CCPs could consider to help assess potential resource needs and coverage for NDLS? (eg stressed business and operational risk scenarios extrapolated from past events, NDL scenarios exacerbated by wider macroeconomic stress, or other hypothetical NDL scenarios)?

As noted above, in line with the PFMI, CCPs use a number of approaches to define the appropriate NDL scenarios, to estimate potential losses, in order to properly size their resources, and to define the tools to be used to address NDLS. We would like to stress, however, that there is no universally applicable set of NDL scenarios for CCPs due to their varying operating models, risk exposures and corresponding mitigating measures, among other things. Therefore, we do not believe that regulators and international SSBs would be able to put in place a required set of specific NDL scenarios that would be applicable to all CCPs.

9. How and to what extent can the potential simultaneous occurrence of default and non-default-related events be taken into account?

CCPs can and do prepare for the potential simultaneous default and non-default events by including scenarios where both types of events occur in the same timeframe. In considering the simultaneous occurrence of such events, it is particularly important to consider the plausibility of such events occurring at the same time. While a CCP must evaluate what is appropriate for its offering, assuming a simultaneous default event for each NDL scenario would lead to scenarios that are likely to be implausible. In part, this is because certain NDL-related risks are risks that only that particular CCP faces. That said, CCP12 recognizes that it may be helpful to evaluate one or a few scenarios involving a simultaneous occurrence of default and non-default events.

10. What factors, in addition to those suggested in the PFMI, might a CCP helpfully consider when calculating the amount of liquid net assets funded by equity that is sufficient to implement its recovery and orderly wind-down plans? How can a CCP effectively incorporate its general business risk profile and the length of time required to achieve recovery or orderly wind-down into this analysis?

The factors set out in the PFMIs for CCPs to consider in calculating the amount of liquid net assets funded by equity (“LNAFBE”) are sufficient for implementing a CCP’s recovery and orderly wind-down. CCPs’ wind-down plans vary based on the specifics of their offerings and the strategies that they have found to be feasible for executing a recovery and orderly wind-down. Thus, it is of the utmost importance that a CCP be able to calculate its LNAFBE considering the unique facts and circumstances that could characterize its wind-down (which is permitted under the PFMIs). That said, CCPs typically evaluate what costs they could incur and what costs would no longer be relevant in a recovery and wind-down situation. For example, depending on their recovery and wind-down strategy, some of the required costs/possible savings during wind-down may include: the salaries and benefits of the key staff that must be retained, the savings from targeted reductions in staff, as well as the costs of any related retention bonuses or severance packages. Moreover, depending on their recovery and wind-down strategies, CCPs may also take into account the lines of business that may be terminated, key agreements to maintain, and the costs related to the structuring of potential recovery and wind-down transactions. As explained above, the cost of wind-down is highly dependent on the given CCP’s strategy, and therefore prescriptive requirements for calculating LNAFBE to support wind-down would not be appropriate.

11. Given the limited availability of historical data on severe NDL events, what do you consider the most important sources of information in developing plans to address NDLS, particularly for potential recovery situations (eg internal expertise, key stakeholders such as clearing participants and service providers, external market experts, relevant authorities, frameworks and practices in place for other types of financial institution)?

First and foremost, we believe it is important to recognize that the lack of historical data on severe NDL events (i.e., events that are extreme but plausible) is a result of CCPs’ strong resilience and is a clear indication of the effectiveness of CCPs’ risk management practices in addressing NDL-related risks over time.

While there is limitation on historical data on severe NDL events, it continues to be important that loss data being considered is relevant to the NDL-related risks posed to the CCP, as well as the specific risk type. Data coming from other institutions may not necessarily be relevant to a CCP and the nature of the risks it faces and therefore may be of limited use. Additionally, average annual loss figures tend to be strongly influenced by individual, institution-specific outliers. That said, external data from financial or other institutions (e.g., operational loss data provided by ORX, IBM FIRST Risk Case Studies) may be used by a CCP to the extent relevant and available.

In light of the very specific offering of CCPs, they cannot mechanically rely on such data to inform decision-making on NDL-related tools and resources. As such, CCPs must have complete discretion in determining which data to use in the context of NDL planning. Ultimately, we believe that internal subject

matter experts are the most important source of information to supplement any limitations with respect to historical data on severe NDLS.

12. Do you have any suggestions for how the clearing industry could leverage loss data from other industries or collaborate to share anonymised loss data?

Please refer to CCP12's response to Question 11.

Additionally, in terms of clearing industry collaboration, some CCPs already confer with other CCPs to discuss what data and approaches they may use to calculate potential NDLS. Given that some of these CCPs have more established practices and experience in this area, there may be further opportunities for information sharing amongst CCPs on this topic.

13. What key measures can help to ensure that capital replenishment could be achieved in a timely and effective manner? Does the clear definition and testing of processes to obtain backup funding from affiliates or external sources underpin the credibility of that funding? How do you assess the current availability of committed or legally binding funding arrangements?

As a part of a CCPs' recovery planning, they maintain viable plans for raising additional equity should their equity fall close to or below the amount needed, which includes triggers for activating the equity capital raising strategy. These plans are informed by a CCP's ongoing monitoring of its capital levels against the related regulatory requirements. Capital replenishment appropriately varies across CCPs based on their specific characteristics, but may involve capital raising, a financial contribution from the CCP's parent, raising fees, or an assessment of clearing members under a utility model. As a part of the regular update process for a CCP's capital raising plan, the CCP will validate the reliability of the plans being executed. We believe that the PFMLs strike the appropriate balance in establishing that a CCP should have a plan for raising additional capital, while recognizing that it must be able to tailor this plan to its unique characteristics and structure. There are many ways in which CCPs can raise additional capital and a CCP should be able to formulate its capital raising plan in a manner that is most appropriate for it.

14. What role should insurance play for NDL, considering potential uncertainties about coverage, pay-out delays and performance risk? Are there certain types of NDL risk for which insurance may be a more appropriate loss-absorbing resource than for other types of NDL risk?

Insurance may also play a role in CCPs' management of NDLS. Insurance coverage, where appropriate and applicable, may include a broad array of incidents, such as: 1) Directors' & Officers' Liability; 2) Civil Liability and Crime; 3) Employment Practices Liability; 4) Pension Trustee Liability; 5) Combined Liability; 6) Terrorism; 7) Property Damage / Business Interruption; and 8) Cyber. While indeed there are potential limitations, such as pay-out delays and performance risk, if properly selected and monitored, insurance can be an important tool for CCPs in the management of NDL-related risks, such as those mentioned above. That being said, CCP12 does not believe that specific tools or resources should be required to

be used to address NDLs, as the focus should be on the fact that a CCP has comprehensive practices in place for addressing NDLs and mitigating the likelihood of them occurring in the first place.

15. What practices might improve CCPs' planning for an orderly wind-down necessitated by NDLs?

We agree with the Discussion Paper that, in accordance with the PFMI, CCPs should maintain effective recovery plans and orderly wind-down plans. As discussed in Section 2.5 of the Discussion Paper, there are a range of approaches that CCPs take in terms of planning for a wind-down resulting from NDLs. The resulting plans would all be different, but would still be consistent with the PFMI. As noted above, CCP12 believes that CCPs should have the necessary discretion and flexibility to determine how to address NDLs in their recovery and wind-down planning, due to the unique characteristics of each CCP's offering and risk profile. For example, for some CCPs, the use of particular recovery tools, resources, and overall wind-down strategy is not dependent on the type of losses that triggered the wind-down. For other CCPs, the type of recovery tool does depend on the type of NDL. For example, CCPs may use insurance to cover certain NDLs and their own capital for others. Such discretion is important for the development and implementation of the plans, because it enables CCPs to determine the sequence and combination of tools to be used whether losses are caused by NDLs or default events.

Furthermore, we believe that practices that promote effective wind-down planning include conducting a prior analysis of the amount of time and costs to achieve an orderly wind-down based on the particular CCP's business and services, and testing of the available recovery tools to the extent possible.

Achieving operational effectiveness (Section 3)

16. Are there any additional notable practices that could promote the operational effectiveness of plans to address NDLs?

As noted in the Discussion Paper, it is an effective practice to set forth tools involving arrangements with third parties in legally binding agreements for enforceability and transparency reasons. CCP12 also believes that proper due diligence of third parties, particularly with regard to NDL-related risks out of the CCP's control (e.g., custody/settlement bank risk), is also a useful practice to ensure that all relevant risks are captured and addressed in a timely manner. Finally, in line with the Discussion Paper and CCPs' current practices, we believe the appropriate focus should be on CCPs' practices for mitigating NDL-related risks (i.e., decreasing the likelihood of NDLs occurring in the first place) rather than on the CCPs' putting in place additional resources in advance for an event that may not occur.

We also welcome that the Discussion Paper recognises the importance of CCPs' having discretion to be able "to identify the most appropriate tool for a specific situation."¹⁵ As such, while we recognize that *ex ante* planning of the order of tools and resources to be used may have benefits, it is vital to provide CCPs with the flexibility to undertake actions based on facts and circumstances of a given event.

¹⁵ *Ibid.*, at p. 14.

17. What approaches might be helpful to ensure that relevant third parties (such as service and liquidity providers) fully understand and are prepared for their potential role in addressing NDLs?

In line with the above, CCP12 believes that the current PFMI are appropriate for defining considerations relevant to a CCP's management of the risks they face arising from third-parties (including their understanding of their roles in addressing NDLs). This is particularly important given the varying types of third-parties and the services for which a CCP relies on these third parties to deliver. That being said, CCPs' approaches for making sure that their critical third-party service providers are knowledgeable and prepared for their potential role in addressing NDLs are already commonly addressed in connection with CCPs' third-party risk management, business continuity and disaster recovery planning and preparedness. Indeed, many CCPs have dedicated areas within their risk management organizations that are focused on assessing and addressing third-party risks, including those resulting from reliance on third-party service providers. CCPs' approaches to assessing the availability and preparedness of third-parties include directly engaging internal stakeholders and critical third parties in exercises in which business continuity and related scenarios are simulated to assess the timing and preparedness of all parties (i.e., internal and external). Further, many CCPs participate in industry forums to provide input on certain risk management practices and discuss expectations of third-party service providers and other stakeholders to assist in efforts to recover from, for example, a cyber event.

Additionally, as part of the initial and ongoing engagement by a CCP of a critical third-party, there are relevant contractual obligations and protections that may be included in a legally binding services agreement between the parties that serve to validate that the third-party understands and acknowledges their obligations and agrees to perform them commensurate with the nature of the services to be provided and complexity of the third party's engagement, including performance under stress scenarios. Such provisions can include, but are not limited to, service descriptions across scenarios, performance criteria and protections and termination provisions. All of these approaches serve to identify potential gaps in third-party availability and test their effectiveness.

18. What are the essential elements of appropriate due diligence vis-à-vis relevant third parties on which CCPs would expect to rely in an NDL event?

Overall, consistent with PFMI (e.g., Principles 3, 7, 9, and 17), CCPs have well-defined processes for conducting due diligence on critical third parties and what controls these parties have in place and thus, we believe that unique treatment for NDL events is not necessary. Such due diligence is performed in connection with preparing for and mitigating a variety of potential risks to the CCP and the marketplace (e.g., credit, reputational, and legal), including, but not limited to, the risk of failure to perform or to have necessary availability of services in an NDL event. This due diligence is not only conducted at onboarding, but also through ongoing operational and financial monitoring to ensure they have the capacity to deliver on their obligations when called upon.

In some cases, the third-party may itself be a regulated entity (e.g., a bank liquidity provider) and as such, is subject to similar regulatory requirements covering an ability to perform services in stress situations, such as a cyber event.

As a general matter, there are key elements of third-party due diligence, which are focused on identifying and supporting mitigation and exit strategies. They include items such as identification of the subset of third parties that the CCP would expect to rely upon in an NDL event, putting provisions and contractual agreements in place that define clear service expectations, audit rights and termination provisions, and evaluating mitigation strategies and insurance coverages.

Additionally, we would like to draw CPMI's and IOSCO's attention to a CCP12 paper issued in 2019 titled "CCP Best Practices Third Party Risk Management – a CCP12 Position Paper"¹⁶. In this paper, CCP12 elaborates on CCP best practices for effective third-party risk management to reduce risks and balance the operational and commercial benefits of these third-party relationships.

19. What are the key factors and constraints that impact the choice and order of different tools for the various types of NDL scenario?

Please refer to our answers to Questions 13 and 15 in this regard. We would like to stress again, however, that while there are pre-defined plans and governance processes that apply in NDL scenarios, the CCP's management must still have discretion in responding to an NDL event (including the choice of tools).

20. What technological tools should be developed to promote the operational effectiveness of plans to address NDLs?

Generally, as evidenced in the Discussion Paper, CCP12 believes that CCPs are well prepared to address NDLs should they occur. The Discussion Paper highlights that some CCPs use technology systems and processes to facilitate the allocation of NDLs. On a daily basis, CCPs demonstrate their ability to facilitate payments (e.g., variation margin and initial margin calls) in a timely manner between their members and as such, CCPs are well placed to be able to facilitate loss allocation relating to NDLs should that be necessary. Also, necessary tools and communication processes with members can generally be applied through CCPs' existing clearing systems.

Reviewing and testing plans for NDLs (Section 4)

21. Are there additional notable practices for reviewing and testing plans to address NDLs?

CCP12 believes the existing practices highlighted in the Discussion Paper and implemented by the majority of CCPs are comprehensive, and include the CCPs' reviewing, updating, and testing their plans to address NDLs on a regular basis.

22. What challenges are there to achieving the goal of increasing the involvement of additional stakeholders in different stages of review and testing of plans to address NDLs?

¹⁶ A CCP12 Position Paper, CCP Best Practices: Third Party Risk Management (July 2019), available at [Link](#)

While general process or communications testing with additional stakeholders may be useful as part of recovery planning, the review and testing of plans to address NDLS with multiple stakeholders is challenging and may provide limited benefits. For confidentiality and other security concerns alone, the review and testing related to certain types of NDLS should not involve market participants or other stakeholders. For example, any testing would need to be based on anonymized data preventing any reverse-engineering of confidential information of market participants, third parties or the CCP. It should also be taken into account that CCPs generally do not share detailed information about their back-up facilities or other defenses. Furthermore, the involvement of external stakeholders would lead to significant differences in outcome between the testing environment and real stressed scenarios, while likely covering only a small part of the potential risk factors. In most cases, the testing and review of the NDLS plan would be more appropriately managed internally by each CCP, with the solicitation of input from external stakeholders by CCPs, where relevant. Therefore, CCP12 cautions against a one-size-fits-all approach that prescribes generalized “stakeholders” involvement in different stages of review and testing of plans to address all types of NDLS.

CCP12 also wishes to emphasize that CCPs already provide public disclosure of their NDLS frameworks through the existing PFMI qualitative and quantitative disclosures, rule filings, and rulebooks, as well as other disclosures which facilitate discussion with interested stakeholders including clearing members. In addition, CCPs engage with stakeholders on these topics in bilateral meetings, risk working groups, risk committees, and CCP boards.

23. Are multi-CCP crisis management drills an effective tool for testing preparedness to address NDLS? Are there any barriers to effectively conducting this type of exercise? What role should authorities play in supporting these exercises?

Given the difference between business models of each CCP, as well as the differing regulatory frameworks under which each CCP operates, CCP12 cautions against prescribing multi-CCP crisis management drills for NDLS without due consideration to the specific nature of each CCP. There are very few scenarios that would affect multiple CCPs simultaneously (e.g., disruptions of a payment system). Considering the different approaches used by CCPs to address NDLS (e.g., different methods of capital replenishment) and the fact that certain NDLS can be specific to individual CCPs, the results of such a resource-intensive joint drill may also be of limited value.

In addition, given the confidential nature of the management and projected impact of NDLS-related risks, (e.g., operational ones), there could be challenges with coordination, particularly in information sharing (e.g., lists of common service providers across different CCPs), as CCPs may not directly be able to, or wish to, share certain sensitive information with other CCPs.

Instead of organizing multi-CCP crisis management drills, which may have limited value, as described above, CCP12 believes that it would be more valuable for CCPs to continue to refine their own internal NDLS frameworks. This could include, among other things, continuing to enhance their potential NDLS scenarios as well as how they address these. In addition, we believe that, at this stage, given the broad range of different types of NDLS-related risks, further exchange of views, practices and experience (except for certain sensitive information) among CCPs would be beneficial.

Providing effective governance, transparency and engagement with participants and authorities (Section 5)

24. Are there additional notable practices for providing effective governance, transparency and engagement with participants and authorities in the context of NDLS?

In line with the introductory comments made above, CCP12 believes that the PFMI and related Disclosure framework establish appropriate and sufficient principles for effective governance, transparency, and engagement with participants in the context of NDLS. With respect to each of these areas the PFMI and Disclosure Framework set out the following:

- **Governance Arrangements:** Principle 2 of the PFMI states that a CCP “should have documented governance arrangements that provide clear and direct lines of responsibility and accountability,” including clearly defining the roles and responsibilities of a CCP’s board (or equivalent) and management. Principle 2 of the PFMI also goes on to state, that “[t]he board should establish a clear, documented risk-management framework that includes the FMI’s risk-tolerance policy, assigns responsibilities and accountability for risk decisions, and addresses decision making in crises and emergencies.” Broadly speaking, Principle 2 of the PFMI, read in conjunction with Principle 3 of the PFMI that states that a CCP should “identify, measure, monitor, and manage the range of risks” that it faces, establishes that a CCP should have governance arrangements that address NDLS and their related risks. The PFMI principles- and outcomes-based approach allows a CCP to adopt governance arrangements for NDLS that allows them to effectively manage NDLS and their related risks in the manner that is most appropriate for them, based on their operating structure and offering, among other things. It is clear based on the Discussion Paper that CCPs are already employing effective governance arrangements in the context of NDLS and that PFMI are appropriate and sufficient in this regard.

For example, the Discussion Paper highlights that CCPs already commonly set out specific formal approaches for addressing NDLS (in business-as-usual and recovery), including employing governance arrangements whereby senior management and ultimately the board review the underlying assumptions and methodologies.¹⁷ The Discussion Paper highlights that governance arrangements for NDLS may either be defined in a CCP’s rules or recovery plan.¹⁸ It also states that some CCPs define the timing, rules, procedures, and governance arrangements for using specific tools for funding or loss allocation.¹⁹

- **Transparency:** The Disclosure Framework sets out comprehensive questions that CCPs are expected to consider in preparing their qualitative PFMI disclosures. Among other things, these questions cover NDL-related risks, including how they are managed – e.g., Principle 1 (legal risk), Principle 15 (general business risk), Principle 16 (custody and investment risk), and Principle 17 (operational risk), among others. The Disclosure Framework further covers a CCP’s governance

¹⁷ Discussion Paper, at pg. 16.

¹⁸ *Ibid.*

¹⁹ *Ibid.*

arrangements (e.g., Principle 2). CCPs provide significant transparency through their qualitative PFMI disclosures, including in the context of NDLS. The Discussion Paper highlights these practices and notes many CCPs share their practices, assumptions, and methodologies for quantifying and addressing NDLS with participants through their PFMI disclosures.²⁰

CCPs also provide expansive disclosures on NDLS and their related risks through other public disclosures, including their rulebooks (and rule filings) and annual reports. Please refer to CCP12's response to Question 25 with respect to the transparency CCPs provide on the rule-based allocation of NDLS.

- Engagement: Principle 2 of the PFMI states that a CCP's board should ensure that the CCP's "design, rules, overall strategy, and major decisions reflect appropriately the legitimate interests of its direct and indirect participants and other relevant stakeholders." In line with the other key considerations under Principle 2 of the PFMI, a CCP's governance arrangements are expected to be designed to reflect the legitimate interests of market participants, which would include in the context of NDLS. There are a number of ways in which CCPs' governance arrangements result in market participant engagement on matters that could have a material risk impact, including through market participant involvement in risk committees, boards, and advisory groups, as well as bilateral engagement. Generally, broad engagement from market participants can be accomplished by either engaging directly or having a representative set of participants participate in forums such as those noted above.

CCP12 believes that the PFMI provide for an appropriate and sufficient framework for CCPs to put in place well-defined governance arrangements to effectively manage NDLS that include appropriate participant engagement, as reflected by the practices highlighted in the Discussion Paper. Similarly, the transparency provided by CCPs through their qualitative PFMI disclosures and other publicly available information provides market participants a strong basis for comprehensively understanding the NDLS-related risks a CCP faces and how such risks are managed. In addition, CCPs readily make themselves available to market participants for bilateral and multi-lateral conversations to answer prevailing questions.

25. What are the most important elements of appropriate processes and governance arrangements for rule-based loss allocation to support clearing members in anticipating and preparing for potential exposures?

Rule-based allocations of NDLS should be transparent to clearing members via CCPs' rulebooks which are already publicly available on their websites. More specifically, with respect to the governance and process for the rule-based allocations of NDLS, these rulebooks should define the circumstances and terms under which a clearing member may be liable for NDLS. This allows clearing members to appropriately anticipate and prepare for their potential exposure. We note CCPs already have this information in their rulebooks today.

²⁰ *Ibid.*, at pg. 17.

About CCP12

The Global Association of Central Counterparties (“CCP12”) is the international association for central counterparties (“CCPs”), representing 40 members who operate over 60 CCPs across the Americas, EMEA, and the Asia-Pacific region.

CCP12 promotes 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, while also actively engaging with regulatory agencies and industry constituents through consultation responses, forum discussions, and position papers.

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