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## Raising Clients' Awareness on Portability

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## INTRODUCTION

Clients accessing a central counterparty (CCP) via a client clearing service provider (CCSP) for over-the-counter (OTC) and exchange-traded derivatives should consider what may happen to their positions and collateral in a scenario in which the CCSP defaults.

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While regulatory regimes provide for various porting mechanisms to transfer client positions to another CCSP, successful porting – of both positions and collateral – can never be guaranteed<sup>1</sup>. Clients should therefore be aware of how the choice of their clearing arrangements will affect the likelihood of successful porting. Clients should also monitor the creditworthiness of their CCSP so they can proactively alter their clearing arrangements ahead of a CCSP default. This would reduce their reliance on porting mechanisms.

Clients should not rely on porting and should be mindful of what may happen if their CCSP defaults – however unlikely this might be. The successful porting of clients after the default of a CCSP can be highly uncertain and largely depends on the clients' access to the

CCP, the provisions that have been made and the local legal framework.

If required, porting can be a challenging process. If the porting of client positions is not completed within the short time window set by the CCP (defined in a matter of days or even hours), the CCP will trigger default management procedures for client positions, meaning there is a risk that clients waiting for positions to be ported might get closed out.

### Key Issues

- Clients should consider what may happen to their positions if their CCSP defaults.
- There is a trade-off between the costs of client clearing arrangements and the likelihood of successful porting:
  - For example, whether to opt for an individually segregated versus net omnibus account structure in the EU and UK, when such choice is available.
  - Whether to clear through a unique CCSP, with a backup CCSP or through multiple CCSPs.
- Those choices come with different cost implications and varying likelihoods of successful porting.
- Clients should actively monitor the creditworthiness of their CCSP(s):
  - This might inform their decision on whether to maintain multiple relationships with CCSPs or rely on one CCSP.
  - It might also enable them to reduce reliance on a CCSP with deteriorating credit quality, mitigating the uncertainty of porting if a default materializes.
- Clients should assess their overall portfolios and consider whether they would be comfortable being closed out of their positions in a CCSP default scenario or if their positions are strategically relevant and should not be closed out.

<sup>1</sup>For an in-depth discussion on the obstacles to porting, please refer to ISDA's whitepaper Addressing Porting Challenges, October 2023, [www.isda.org/2023/10/10/addressing-porting-challenges/](https://www.isda.org/2023/10/10/addressing-porting-challenges/)

## CHOICES OF CLEARING ARRANGEMENTS INFLUENCE THE LIKELIHOOD OF SUCCESSFUL PORTING

Clients can make various choices about their clearing arrangements, many of which depend on the regulatory regime applicable to the CCSP. These choices will influence the likelihood of porting being successful in the event of a CCSP default. Clients that opt for segregated account structures in certain jurisdictions and maintain active clearing relationships with several CCSPs might bear extra costs for these choices<sup>2</sup>, but porting will have a significantly higher likelihood of success in the event of a default of their primary CCSP. It is important that clients are aware of this trade-off so they can make informed choices about their clearing arrangements.

For those clients that opt for arrangements more conducive to porting, it is crucial they become familiar with the details of the porting process at each CCP and their alternative CCSPs to ensure readiness, as the periods allowed for porting tend to be short. For this purpose, some CCPs offer regular porting exercises for clients and CCSPs to test their operational arrangements.

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### Different Account Structures

In certain jurisdictions, such as the UK and EU but not the US, a choice of account structure is available – for example, individually segregated or omnibus accounts. Clients using an EU CCSP with an omnibus account structure should be aware that porting is likely to be extremely challenging following a default of their CCSP and should not be relied on.

This is because client positions in a net omnibus account (a concept often present outside the US) would be very hard to port if individual clients wanted to go to different CCSPs or if every party within the omnibus account is required to agree to port before this can occur. Depending on the type of account structure used, CCPs might not know the identity of the end client and would therefore be restricted in their ability to assist, making the porting process more challenging.

At some CCPs, the client can opt for gross omnibus segregation, meaning its positions are separate from those of other clients and collateral is allocated to the client, making porting easier if another CCSP is willing to accept these positions.

If a client opts for an account structure that provides individual legal segregation (or a similar structure like the US Commodity Futures Trading Commission's (CFTC) legally segregated, operationally commingled model), its positions and collateral are separate from those of other clients, making porting easier (assuming there is another CCSP that is willing to accept the positions).

The choice of account structure also has a bearing on the ease with which collateral may be ported. At certain CCPs, the client's collateral would be left with the clearing member following a default, meaning client positions would have to be ported without the collateral. Clients would have to post collateral with their new CCSPs without being able to quickly recoup the collateral posted with the defaulted CCSP, potentially leading to increased collateral requirements. Clients

<sup>2</sup>For avoidance of doubt, certain regulators, such as the Commodity Futures Trading Commission (CFTC), only offer segregated account structures under a gross margining regime

should maintain a clear view of what collateral they have posted and where it resides<sup>3</sup>. In some jurisdictions, there are requirements for each client in an omnibus account to agree to porting or select the clearing member their positions would be ported to, otherwise local bankruptcy law might make the transfer of collateral more difficult or less timely.

In the US, the positions and collateral of all clients are held in gross omnibus accounts at the CCSP, with certain technical variations based on whether the account relates to listed futures or swaps. When the CFTC issued its revised bankruptcy rules<sup>4</sup> for CCSPs (futures commission merchants in the US) and CCPs (derivatives clearing organizations) in 2021, it established a policy preference for porting (rather than liquidating) customer positions and associated collateral from an insolvent CCSP to a solvent one, subject to the availability of solvent CCSPs. The CFTC acknowledged there are practical limits to how long contracts will be held open before being liquidated<sup>5</sup>.

### Choosing a Unique CCSP, a Back-up CCSP or Multiple CCSPs

Even if a client using an EU or UK CCSP has chosen individual segregated accounts, or if it is using a US CCSP, porting might not be possible if a new CCSP is not found in time. CCSPs are required to go through an extensive onboarding process, which includes performing know-your-customer and anti-money laundering checks, reviewing the client's portfolio and risk profile, completing credit onboarding and setting up operational processes. A CCSP is unlikely to be able to do this in the short period available for porting for clients.

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Clients should therefore weigh up the costs and benefits of setting up and maintaining several active clearing arrangements versus the risk of having positions closed out following the default of a CCSP. There are drawbacks to clearing through multiple CCSPs, especially for smaller clients, as additional account and maintenance fees would add to costs. However, it would be easier for clients to port their portfolios to alternative CCSPs if they have multiple CCSP relationships in the first place – operationally, clients would be able to initiate the transfer of their positions. This might also allow the

splitting of positions across multiple CCSPs following a default event. Some CCPs offer regular porting exercises for clients and CCSPs to test operational arrangements to ensure readiness, as porting periods tend to be short following a default.

Larger clients that have more than two CCSPs should consider utilization levels versus existing limits across their various clearers to better prepare for a default event: porting to another account at an alternative CCSP may breach existing credit risk appetite levels. Higher utilization levels may require extra funding/pre-funding, as required by the CCSP.

<sup>3</sup> Under the CFTC's legally segregated, operationally commingled model and EU/UK individual segregated accounts, collateral resides at the central counterparty (CCP). Under many net omnibus account models, the CCP requires net margin across all client positions in the net omnibus account, but the CCSP calls its clients for gross margin. Usually, this excess margin (the difference between the gross margin obtained from clients and the net margin posted to the CCP) remains in the CCSP's accounts

<sup>4</sup> 17 C.F.R. Part 190.

<sup>5</sup> Bankruptcy Regulations (applicable to futures commission merchants and derivatives clearing organizations), 86 Fed. Reg. 19,324, 19,329, April 13, 2021, [www.cftc.gov/sites/default/files/2021/04/2020-28300a.pdf](http://www.cftc.gov/sites/default/files/2021/04/2020-28300a.pdf). See also ISDA's whitepaper, Addressing Porting Challenges, October 2023, page 4, [www.isda.org/a/dq7gE/Addressing-Porting-Challenges.pdf](http://www.isda.org/a/dq7gE/Addressing-Porting-Challenges.pdf)

Some clients might decide they are comfortable with the creditworthiness of their current CCSP and therefore opt for the most cost-effective clearing model with no alternative CCSP(s). In this case, the client should continue to monitor the creditworthiness of that CCSP. Others might prefer to clear through multiple CCSPs, making portability easier in the event of a default as it would allow positions to be split across multiple CCSPs. However, this arrangement would come at the cost of reduced margin efficiency and higher fees.

A pre-arranged clearing agreement with alternative CCSPs cannot be interpreted as a guarantee for porting an entire portfolio irrespective of its size and directionality. Alternative CCSPs would need to consider whether they have the capacity in terms of capital allocation and risk limits to absorb a client's portfolio (potentially during market stress). Those risk management considerations are dynamic, meaning the alternative CCSP cannot pre-commit to taking on positions.

## PORTING MIGHT NOT ALWAYS BE THE BEST COURSE OF ACTION

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Clients might also decide they would rather be closed out than having to deal with the uncertainty of whether they will be ported and the financial risks arising from this uncertainty. For example, clients would not be able to risk manage their positions while they are trying to port them. Porting therefore might not be the best course of action, especially if it is unsuccessful and results in forced

liquidation by the CCP. This could lead to losses that eat into the CCP waterfall and affect non-defaulting clearing members. As a result, opting not to port could benefit both clients (ability to trade out) and the CCP and its non-defaulting members.

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## ABOUT ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 76 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In

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