

Response to the Bank of England Consultation Paper “Operational Resilience: Central Counterparties”

Summary

FIA and ISDA (together the “Associations”) welcome the Bank of England’s consultation paper (CP) on operational resilience of Central Counterparties (CCPs). We applaud the UK authorities for focusing on the operational resilience of the entire financial sector – including Financial Market Infrastructures (FMIs) such as CCPs. We agree with the Bank of England’s assessment that disruption to clearing markets is a financial stability issue and support the policy objective for CCPs to be operationally resilient to disruption events. We also support the concepts of important business services and impact tolerances.

The Associations’ comments from the point of view of clearing members and their clients are:

- We believe that clearing members and their clients (collectively referred to as “clearing participants”) should have a voice in both identifying important business services and determining the impact tolerances.
- In addition, clearing participants should have a voice in determining the criteria for important business services. This is especially important as FMIs are very interlinked and no single FMI or market participant will have a view of how its service interplays with other FMIs and the wider market.
- Metrics on important business services should also be shared with affected clearing participants.
- Clearing participants should be included in testing.

In this response, the Associations represent clearing members and their clients.

Response

The Associations welcome this consultation paper on operational resilience of central counterparties and agree with the concept of important business service and most of the conclusions flowing from the introduction of important business services and impact tolerances.

Main comment – requirement for customer input

The consultation paper is largely focused on the steps CCPs should themselves take to be operationally resilient to disruption events. Given that CCPs provide important business services for the benefit of clearing participants, we believe that such clearing participants should have a voice in both

- identifying important business services and
- determining the impact tolerances

as ultimately the clearing participants are the commercial entities that are dependent of these business services. For the avoidance of doubt, we ask for a voice in defining important business services and impact tolerances, not in how the CCP meets these service levels.

We also note that FMIs are very interlinked. Some of these links are direct and are visible to CCPs, while others are less direct and therefore less visible to CCPs. Such interdependencies may be more visible for the users of CCPs and linked FMIs and will affect what services are important and what the impact tolerances would be.

We see two ways of clearing participants feeding into the determination of important business functions and their impact tolerances:

- Agreeing the criteria being used by the CCP
- Opining in a consultation on the important business services and their impact tolerances.

These two proposals are not mutually exclusive, and in fact both should be implemented.

For criteria please refer to the next section.

For a consultation, there are two options:

1. The Bank consults clearing participants directly.
2. The CCP defines the important business service and impact tolerances and consults their participants on their proposal.

In either approach we would welcome if the Bank has visibility of the feedback provided by clearing participants on a granular basis. In the first approach the Bank has the visibility of feedback implicitly. In the second approach the CCP would have to be required to provide all feedback to the Bank, together with the response of CCPs staff and an opinion by the risk committee.

Criteria for important business services (2.13)

The CP lists the following criteria for important business services:

- Share of the relevant market.
- The number of members the CCP serves.
- The risk profile of the transactions conducted through the business service.
- The substitutability of the business service.
- Regulatory driven activity (such as enabling the clearing obligation to be met) or external obligations.

We suggest that clearing participants are consulted on which criteria should be used, before the CCP commences the process of defining important business services. Clearing participants might suggest additional criteria like their ability to manage their portfolios and risk. As an example, the volume of cleared transactions can affect operational risk and capital requirements for clearing participants. To manage both operational risk and the capital requirements linked to a large number of transactions, clearing participants rely on widespread compression. They might well come to the conclusion that compression is an important business service, while CCPs might not as they don't have visibility of the consequences for their participants if volumes increase.

While we are mindful that the list of criteria for important business services in the CP was meant as examples, we note that certain of the criteria may not be appropriate to determine important business services in some circumstances. For example, the number of members the CCP serves might not be relevant if the CCP has a small number of very large clearing members. Also, substitutability in clearing will always ever only affect ancillary services (for instance data feeds) – due to long onboarding lead-times it is not easily conceivable that clearing participants are able to substitute clearing related services of a CCP quickly.

Metrics and transparency (2.29)

We agree with the proposal that CCPs should set out the “metrics that it will consider and monitor when setting a tolerance, which may be qualitative or quantitative”.

We however propose that these metrics are made available not only to the Bank, but also to those clearing participants which are directly affected. This does not mean that all participants need to see all metrics: Clients would for instance not need to see metric that cover financial loss to clearing members.

Testing (2.36)

Once the framework has been implemented and CCPs have run their first successful tests, they should consider including clearing participants in future tests. This could be done either in test systems or even as live test if the outages are kept short enough to not affect the important business services of the CCP's customers.

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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 925 member institutions from 75 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 addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.

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FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C.

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- support open, transparent and competitive markets,
- protect and enhance the integrity of the financial system, and
- promote high standards of professional conduct.

As the leading global trade association for the futures, options and centrally cleared derivatives markets, FIA represents all sectors of the industry, including clearing firms, exchanges, clearing houses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry.