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# Addressing Porting Challenges

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## 1. EXECUTIVE SUMMARY

In their September 2022 report on client clearing and porting<sup>1</sup>, the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) set out the key obstacles to the portability of clients' positions following the default of a client clearing service provider (CCSP).

CPMI-IOSCO subsequently encouraged the industry to enhance portability. This paper reflects ISDA's latest exploration of porting challenges. While there are important jurisdictional differences that would impact the ability to port positions, this paper considers a number of factors that are relevant to the likelihood of porting. From this analysis, it appears that constrained clearing capacity at non-defaulted CCSPs, largely driven by capital implications, would be an issue in most circumstances. Other factors influencing the likelihood of porting relate to consent mechanisms, onboarding processes, account structures and the overall complexity of a multi-part process such as porting.

Based on this analysis, ISDA believes the overarching objective should not be to ensure porting in all circumstances, but rather to frame portability as a feature for clients to consider when designing their clearing arrangements, weighing up the costs and benefits of arrangements that increase the likelihood of successful porting. Such arrangements might include opting for individually segregated accounts, where choice is available, and maintaining clearing relationships with alternate CCSPs. However, the analysis suggests porting cannot be guaranteed, even under favorable clearing arrangements, because of constrained clearing capacity among CCSPs, the short time window available to port positions and the idiosyncratic nature of default scenarios.

While porting positions in business-as-usual circumstances does not pose any particular difficulties for central counterparties (CCPs), it becomes a more complex process when triggered by the default of a CCSP. Any opportunity for further testing could help to identify practical obstacles and ensure CCPs' timelines are realistic and scalable. There might also be value in looking into ways to extend the porting window without impacting the ability of CCPs to manage their risks.

As a tactical solution, it would be worth exploring whether CCPs could enable clients to post margin to them directly<sup>2</sup>, to extend the time window during which the CCP, alternate CCSPs, and clients could organize the porting of positions. As a structural solution, bank resolution authorities' decisions will play a critical role with respect to the ability of the CCSP entity within a bank that has entered into resolution to continue providing client clearing services, at least for a short period of time. This would allow clients to move positions in an orderly way. It might also avoid the CCSP being defaulted at key CCPs altogether, making porting less necessary.

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<sup>1</sup> Client clearing: access and portability, Committee on Payments and Market Infrastructures (CPMI), International Organization of Securities Commissions (IOSCO), September 2022, [www.iosco.org/library/pubdocs/pdf/IOSCOPD712.pdf](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD712.pdf)

<sup>2</sup> In this respect, some central counterparties (CCPs) already offer account structures that would enable clients to post margin directly to them

## 2. INTRODUCTION

This paper explores the factors that influence portability, building on existing work on this issue. In their final report on client clearing and porting, published in September 2022<sup>3</sup>, CPMI-IOSCO asked the industry to carry out further work on this topic. CPMI-IOSCO also stated that they “welcome and encourage industry efforts to enhance portability, so that client clearing access can continue to be provided following a default and forced liquidations are avoided”.

This paper considers porting across all product classes, given that many of the identified issues are common across over-the-counter (OTC) and exchange-traded derivatives. This paper explores the various factors that have been identified as relevant to porting, suggesting potential ways to increase the likelihood of successful porting, where appropriate. It also highlights that the porting of positions might not be the most desirable outcome for clients in all circumstances.

### Different Legal Frameworks

Before exploring individual factors that affect the likelihood of porting, it is important to address the differences in the legal frameworks relevant for porting across key jurisdictions.

- In the US, the Bankruptcy Code and the Commodity Futures Trading Commission’s (CFTC) Part 190 regulations provide a favorable regime for porting by noting that the appointed bankruptcy trustee will use its best efforts to transfer clients’ contract accounts and property following the default of a CCSP registered with the CFTC. The overarching objective that all clients’ positions will be ported is theoretically enabled by the requirement to use the ‘legal segregation, operational commingling’ model for cleared swaps;
- In the EU and the UK, the European Market Infrastructure Regulation (EMIR) requires a CCP “to contractually commit itself to trigger the procedures for the transfer of the assets and positions held by the defaulted clearing member for the account of its clients”<sup>4</sup>, subject to clients’ positive consent.

Unlike in the US, there is no statutory requirement under EMIR to appoint a trustee with responsibility to transfer on a best-efforts basis. However, even where the statutory requirements aim to ensure all clients’ positions will be ported (as in the US), there are still issues relating to clearing capacity and onboarding, such that porting would not be guaranteed even with supportive regulation and account structures<sup>5</sup>.

### Factors Relevant to Successful Porting

Based on ISDA’s most recent analysis and collection of feedback, there are five categories of factors that may influence the likelihood of successful porting. These are addressed in further detail in Section 6.

Category 1: Constrained clearing capacity at the level of alternate CCSPs;

Category 2: Consent mechanisms;

Category 3: Onboarding processes;

Category 4: Account structures;

Category 5: Overall complexity of the process.

<sup>3</sup> Client clearing: access and portability, CPMI-IOSCO, [www.iosco.org/library/pubdocs/pdf/IOSCOPD712.pdf](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD712.pdf)

<sup>4</sup> This is set out under Article 48(5) of the European Market Infrastructure Regulation (EMIR) for positions in omnibus segregated accounts and Article 48(6) for positions in individually segregated accounts

<sup>5</sup> Supportive account structures like the Individual Segregated Account in the EU applies mostly to over-the-counter derivatives, but is hardly used for exchange-traded derivatives

Some of these factors can create hurdles that make porting highly unlikely. For example, the absence of a pre-existing clearing relationship with alternate CCSPs would require appropriate due diligence on a new client by the alternate CCSP as part of its onboarding processes. It is likely that this would not be feasible within tight time frames. Clients that opt for net omnibus account structures should accept that porting cannot be guaranteed, as collateral cannot easily be moved from the defaulted CCSP to the alternate CCSP. Similar issues have also been observed when porting positions under individually segregated accounts, creating an additional collateral requirement for the client. In the EU, the requirement for explicit consent from all clients in a net omnibus account prior to porting would make successful porting within tight time frames even more difficult.

Some of these hurdles pertain to clients' choices around their clearing arrangements (see Section 4), but overcoming each of these individual hurdles would not be sufficient to ensure successful porting, due to various other factors.

Most importantly, CCSPs face multiple constraints on their ability to accommodate new client clearing business. Even when a client has an existing clearing arrangement with an alternate CCSP, porting cannot be guaranteed because of the impact of the ported positions on the alternate CCSP's risk appetite, risk limits and scarce resources allocated to business lines (eg, regulatory capital, liquidity and global systemically important bank (G-SIB) capacity).

The breadth of these impacts might be very difficult for the alternate CCSP to appreciate ex-ante. For example, the precise composition and size of the client portfolios might not be known before a porting event. The alternate CCSP might be constrained in its capacity to take on the defaulted CCSP's client positions if they would significantly increase its regulatory requirements, especially if the added client clearing activity resulted in the CCSP moving to a higher bucket under the G-SIB framework. Temporary relief from capital and liquidity requirements might help, but would not address the structural reduction in clearing capacity in the financial system.

Finally, the overall complexity of a multi-part process such as porting, and any idiosyncratic obstacles that will inevitably arise in a CCSP default scenario, suggest there is currently no simple solution. Both the impediments to porting and the possible solutions depend on the specifics of the CCP and the positions to be ported, on the account structures offered and on the relevant jurisdictions.

### 3. POSSIBLE INITIATIVES TO INCREASE THE LIKELIHOOD OF SUCCESSFUL PORTING

Given the many factors that influence the likelihood of successful porting, there is no obvious or comprehensive solution that would guarantee porting in all situations. In some situations, porting might not even be the most desirable outcome (see Section 4). However, multiple initiatives could help to improve the likelihood of successful porting (see Section 6).

Possible initiatives include:

- Forbearance on certain regulatory requirements (anti-money laundering (AML) and know-your-customer (KYC) checks, capital, leverage and liquidity) and tweaks to capital rules – for example, recognizing the full value of initial margin (IM) with no floor when calculating the counterparty credit risk-weighted assets. However, forbearance on KYC/AML requirements would not be sufficient, as CCSPs still have to make themselves comfortable with onboarding a new client. Similarly, CCSPs would still have to run credit risk checks to be able to prudently manage their risk.
- Facilitate CCSPs' readiness for porting scenarios. This could be supported by CCSPs having pre-defined decision-making procedures in relation to porting, taking into account the impact of porting on their overall risk appetite, internal risk limits and regulatory requirements (capital, liquidity requirements and G-SIB capacity). Standardized client portfolio data might also help CCSPs in their assessment of the impact of having to port a client's portfolio on their risk profile and resources.
- Regular tests along the clearing chain, following a CCSP default scenario, would help with all participants' readiness, and the experience of these tests could feed into each participant's design of its own playbooks and decision-making procedures on porting. This would help to ensure CCPs' timelines are realistic, fit for purpose and scalable, and also help identify elements of porting processes that could benefit from automation and harmonization, if applicable.
- Split portfolios over several CCSPs, rather than assuming the porting of positions would mean moving all of a client account to a single alternative CCSP. This should be explored in a way that ensures the split does not increase risk, also considering how the collateral would be split across multiple CCSPs. For this solution to work, clients would typically need to have pre-existing clearing activity with multiple CCSPs.
- Extend the porting window to gain time for clients to move positions in an orderly manner – for example, by allowing clients to pay variation margin (VM) to the CCP directly for a limited period.
- Automate and standardize data and processes for porting, reducing the risk of operational issues. This might include identifying how technology and vendors could play a role in creating a centralized platform to assist CCPs in communicating and coordinating default events.

## 4. CONSIDERING NON-PORTABILITY AS AN OPTION

While the initiatives set out in Section 2 could help to increase the likelihood of successful porting, attempting to make porting work in all circumstances might not be the best course of action.

There might be a case for CCPs, CCSPs and clients to identify ex-ante which accounts would be portable or non-portable. This would depend on how the various factors that have been identified as influencing the likelihood of porting apply to a particular situation – for example, depending on a particular client's type of positions, its choice of account structures and whether it has relationships with alternate CCSPs. It is worth considering whether porting would be easier if a portfolio could be split across multiple CCSPs, but clients must bear in mind the instruments and limits agreed with each CCSP.

There is therefore a trade-off between the cost of clearing and the likelihood of successful porting. Where a choice of account structures is available (for example, in the EU), clients opting for segregated account structures, in conjunction with maintaining active clearing relationships with several CCSPs, might bear extra costs for these choices. However, they also benefit from a significantly higher likelihood of successful porting in the event of the default of their primary CCSP.

The decision on whether to establish multiple clearing arrangements with alternate CCSPs should be a matter for clients to consider, weighing up the costs and benefits of setting up and maintaining several active clearing arrangements against the risk of having their positions closed out in the event of a CCSP's default. Some clients might decide they are comfortable with the creditworthiness of their current CCSPs, and therefore opt for the most cost-effective clearing model with no alternate CCSPs. Others might prefer to clear through multiple CCSPs, to be less reliant on any single one, making portability easier in the event of a default of one of the CCSPs. However, this arrangement would come at the cost of reduced margin efficiencies and of keeping several relationships and fee schedules. This underlines the importance of encouraging clients to stay alert to the creditworthiness of their CCSPs, should they choose to clear via a single CCSP.

In any event, a pre-arranged clearing arrangement with alternate CCSPs cannot be interpreted as the alternate CCSP guaranteeing porting for an entire client's portfolio irrespective of its size and directionality. The alternate CCSPs would need to consider whether they have the capacity, in terms of capital allocation and risk limits, to take on the clients' portfolio.

For certain types of portfolio, some clients might accept the risk of not having their positions ported, especially those with short-maturity positions (eg, clients with positions in future contracts), so porting might not be the best outcome for them.

Clients might also decide they would rather be closed out than deal with the uncertainty of whether they will be ported and the financial risk arising from this uncertainty. For example, during the time they would be trying to port their positions, clients would not be able to risk manage those positions. In some situations, porting might therefore not be the best course of action, especially if porting is unsuccessfully attempted and ultimately concluded with forced liquidation, which could lead to losses tapping into the CCP waterfall, impacting non-defaulted clearing members. As a result, not attempting porting in all circumstances might also protect against the risk of CCPs having to liquidate clients' positions following unsuccessful porting attempts within the initial porting window<sup>6</sup>.

<sup>6</sup> Under Article 48 of EMIR, CCPs are required to contractually commit themselves to attempt to port positions, subject to clients' positive consent. However, these attempts are likely to be unsuccessful if the client does not have a pre-existing relationship with the alternate client clearing service providers

It is important that clients are aware of this trade-off so they can make an informed choice about their clearing arrangements, accepting how these choices might affect the likelihood of successful porting. CCSPs' disclosures to their clients already address this, drawing out the features of different account types and what they mean for portability.

## 5. INTERPLAY BETWEEN BANK RESOLUTION STRATEGIES AND PORTING

Bank resolution regimes are relevant to porting, and the interplay between the two is therefore worth further exploration.

### Continuity of Clearing Functions in Resolution

This review of the obstacles to porting suggests there is no single solution that would significantly increase the likelihood of, or guarantee, successful porting in all situations. The resolution regime for banks may reduce the likelihood of a scenario in which a CCP has to declare a CCSP in default and begin porting. This is in light of the Financial Stability Board's (FSB) *Key Attributes of Effective Resolution Regimes for Financial Institutions*, with respect to ensuring the continuity of clearing services (see paragraph 2.3 of the FSB's Key Attributes<sup>7</sup>).

Following that principle, resolution authorities would reasonably be expected to ensure the CCSP entity within a bank that has entered resolution would continue to meet all obligations and additional requirements expected by the CCP, as set out under Section 1.3 of the FSB's *Guidance on Continuity of Access to Financial Market Infrastructures (FMIs) for a Firm in Resolution*<sup>8</sup>. If all obligations required by the CCP are met by the CCSP, then the CCP would not need to declare a default.

In this context, it is worth exploring the role bank resolution authorities would play with respect to clients' positions in a resolution scenario, in a way that maintains continuity of access to CCPs. Because porting of positions can never be guaranteed, including for clients that maintain multiple clearing relationships, there appears to be a critical role for resolution authorities to play in ensuring continuity of access to clearing can be maintained following the default of a CCSP.

As part of their resolution strategies, resolution authorities could carve out the client clearing business of a defaulted institution to ensure the continuity of clearing services by maintaining the CCSP entity's operations, at least for a short period of time. During that time, clients could elect to move their positions of their own volition. They would still rely on the CCP's porting functionality, but would benefit from a longer period of time to move positions.

In addition, the FSB's Guidance sets out that the firm and resolution authority should consider, as part of the resolution plan, "the timing and feasibility of porting clients during resolution and the financial and operational implications for the firm of doing so".

Further to the guidance, the FSB also published a standardized questionnaire for FMIs to support resolution planning<sup>9</sup>. The questionnaire includes a question on porting, asking: "What assistance would the FMI provide with the porting (within the FMI) of the participant's direct and/or indirect positions/outstanding transactions to a parent/subsidiary membership, third-party successor or bridge entity?"

<sup>7</sup> Key Attributes of Effective Resolution Regimes for Financial Institutions, Financial Stability Board (FSB), October 2014, [www.fsb.org/wp-content/uploads/r\\_141015.pdf](http://www.fsb.org/wp-content/uploads/r_141015.pdf)

<sup>8</sup> Guidance on Continuity of Access to Financial Market Infrastructures (FMIs) for a Firm in Resolution, FSB, July 2017, [www.fsb.org/wp-content/uploads/P060717-2.pdf](http://www.fsb.org/wp-content/uploads/P060717-2.pdf)

<sup>9</sup> FSB Continuity of Access to FMIs for Firms in Resolution: Streamlined information collection to support resolution planning, FSB, August 2021, [www.fsb.org/wp-content/uploads/P200821-2.pdf](http://www.fsb.org/wp-content/uploads/P200821-2.pdf)

More recently, the FSB published a statement<sup>10</sup> on feedback received through these questionnaires. In this statement, the FSB re-emphasizes that “access to FMI services is essential for banks to be able to continue performing their critical functions or critical services under all circumstances, including in cases where banks need to be resolved”. The FSB also encouraged information sharing between FMIs and their users about continuity of access.

Resolution authorities have already taken steps to implement the principle of continuity of access to FMIs in resolution planning, as highlighted in the FSB’s *Thematic Review on Bank Resolution Planning* (2019)<sup>11</sup>, which noted at the time that the UK and US regimes cover this point in playbooks. The US Federal Reserve notes in its 2019 guidance that a firm’s resolution plan should “describe arrangements to facilitate continued access to payment, clearing and settlement services through the firm’s resolution”<sup>12</sup>. This is also part of the Bank of England’s approach to assessing resolvability<sup>13</sup>. The latest FSB resolution report suggests this principle is widely embedded in jurisdictions’ resolvability approaches to G-SIBs<sup>14</sup>. These arrangements will also avoid the fire-sale of non-ported client positions, limiting further loss mutualization among non-defaulting CCSPs at the CCP.

In addition, Annex 5, Paragraph 1.3 of the FSB’s Key Attributes specifies that a CCP cannot terminate a financial contract with a firm solely because it has entered resolution or because the resolution authority has exercised resolution powers<sup>15</sup>. This suggests that the provision of clearing services by the firm subject to resolution measures should continue, even in a resolution scenario, as long as the CCSP entity within the firm in resolution continues to “meet any margin, collateral or settlement obligation that arise under a financial contract or as a result of the firm’s membership or participation in an FMI”.

If the CCSP entity is meeting its obligations, entry into resolution is not supposed to trigger a default of the CCSP at the CCP, and porting would not be required, at least not immediately. However, if a firm that has entered into resolution fails to meet any obligation arising from its membership in an FMI, default would be triggered. The same paragraph clarifies that “if a firm in resolution fails to meet any margin, collateral or settlement obligations that arise under a financial contract or as a result of the firm’s membership or participation in an FMI, its counterparty or the FMI would have the immediate right to exercise an early termination right against the firm in resolution”.

<sup>10</sup> Continuity of access to financial market infrastructure (FMI) services for firms in resolution, FSB, July 2023, [www.fsb.org/wp-content/uploads/P260723-2.pdf](https://www.fsb.org/wp-content/uploads/P260723-2.pdf)

<sup>11</sup> Thematic Review on Bank Resolution Planning: Peer Review Report, FSB, April 2019, [www.fsb.org/wp-content/uploads/P290419.pdf](https://www.fsb.org/wp-content/uploads/P290419.pdf)

<sup>12</sup> Final Guidance for the 2019 and subsequent resolution plan submissions by the eight largest, complex US banking organizations, Federal Reserve, [www.federalregister.gov/documents/2019/02/04/2019-00800/final-guidance-for-the-2019#citation-23-p1446](https://www.federalregister.gov/documents/2019/02/04/2019-00800/final-guidance-for-the-2019#citation-23-p1446)

<sup>13</sup> The Bank of England’s approach to assessing resolvability, Bank of England, July 2019, Appendix 3, [www.bankofengland.co.uk/-/media/boe/files/paper/2019/bank-of-englands-approach-to-assessing-resolvability-ps.pdf](https://www.bankofengland.co.uk/-/media/boe/files/paper/2019/bank-of-englands-approach-to-assessing-resolvability-ps.pdf)

<sup>14</sup> 2022 Resolution Report: Completing the agenda and sustaining progress, FSB, December 2022, Annex 3, [www.fsb.org/wp-content/uploads/P081222.pdf](https://www.fsb.org/wp-content/uploads/P081222.pdf)

<sup>15</sup> In the EU, this principle is implemented with Article 68 of the Bank Recovery and Resolution Directive. Provided that the substantive (financial) obligations under the contract continue to be performed, it states that a crisis prevention measure or a crisis management measure taken (such as the activation of the bank clearing member’s recovery plan as a result of an early intervention measure) should not make it possible to exercise any termination, suspension, modification, netting or set-off rights

The ways in which resolution authorities approach continuity of clearing during resolution, and how CCPs and their supervisors might react to any action taken by the resolution authority, in keeping with the FSB principles, is worth exploring. In particular, resolution authorities may take action to ensure the CCSP continues to meet obligations placed on it by the CCP so that a default is avoided. This could potentially provide some reassurance that porting would not immediately be needed in an orderly resolution scenario. Clients might still opt to move to another CCSP, but in a less disruptive manner than if forcing the porting of positions following a disorderly default event.

This is an area where more supervisory cooperation between bank resolution authorities and CCP supervisors would be very helpful, including through resolution fire drills, which would improve understanding of what would happen with clients' positions in such a situation.

## 6. DETAILED ANALYSIS OF FACTORS RELEVANT TO THE LIKELIHOOD OF PORTING

As noted in Section 2, ISDA has identified a number of factors that have a bearing on portability.

These factors can be classified in the following categories:

- Category 1: Constrained clearing capacity at the level of alternate CCSPs;
- Category 2: Consent mechanisms;
- Category 3: Onboarding processes;
- Category 4: Account structures;
- Category 5: Overall complexity of the process.

The following analysis also includes potential ways to address these issues and increase the likelihood of successful porting, as summarized in Section 3.

### Category 1: Constrained Clearing Capacity at the Level of Alternate CCSPs

#### Capital/Balance-sheet Impact

Even where a client has a backup CCSP, this does not guarantee successful porting, as the backup CCSP may not be able to take on the clients' positions because of the potential impact on its risk appetite, risk limits and regulatory requirements. Because banks have to allocate capital, liquidity and G-SIB capacity to their businesses (including also managing the risk of a reclassification to a higher G-SIB bucket), they might have limited capacity to accommodate additional client clearing business.

Capacity-related obstacles will be magnified in the event of a large CCSP default, as the volume of positions to be ported will likely be much larger, with commensurate impacts on the backup CCSP's resources and risk limits.

Capacity concerns have become more relevant over the past 10 years, over which several large CCSPs have left the business. Concentration of CCSPs is considerably higher now, and may continue to become more concentrated based on newly proposed G-SIB rules. Should a large CCSP fail, there are fewer alternate CCSPs that could bid in the auction or accept clients of the defaulted CCSP.

#### Risk Management Considerations

Incomplete information on the precise size and make-up of the client's portfolio ahead of a porting scenario might hamper the ability of CCSPs to take a risk management decision on whether to take in the clients' positions. After a default, there could also be a tightening appetite for certain products, depending on what prompted a CCSP's default or because of a potential broader market stress at the time of the default. For a CCSP, there is a risk aspect to signing up a new client that might not fit its risk profile, or the new client's positions might not fit within existing risk appetite or risk limits. Large clients might have to split positions across several backup CCSPs due to their size.

## Potential Ways to Address these Issues

As summarized in Section 3 of this paper, the following initiatives may also help to increase the likelihood of successful porting.

Temporary regulatory forbearance on prudential requirements (capital, liquidity, G-SIB capacity) would help to address issues arising from constrained clearing capacity, even though temporary forbearance would not cover additional prudential requirements for the duration of new client exposures.

## Potential Mechanisms to Help Alternate CCSPs Manage their Risks

CCSPs need to be able to assess the impact of porting in clients' positions on their overall risk profile. To help with planning, improved information on the precise make-up of the clients' portfolios would help. In this respect, certain initiatives could help clearing members with planning for porting scenarios in business-as-usual circumstances. For example, CCPs could set up default management committee equivalents, where some CCSPs are shown hypothetical but representative client portfolios, which would present similar risk characteristics as real portfolios, to help CCSPs assess capital impacts and other issues if their firms were to be asked to take on such hypothetical client portfolios. These representative portfolios could also be included in testing exercises. CCPs could also have the ability to provide information in real time to CCSPs on the impact to overall IM and default fund contributions if a given client were to be ported in.

In an actual porting scenario, pre-arranged data packs on clients' portfolios could help CCSPs coordinate to porting at multiple CCPs, allowing for a faster assessment of combined portfolios. It is also important for data to be provided to CCSPs in a coordinated way and in a standardized format, so that CCSPs can carry out full portfolio assessments, especially if they receive porting requests from several CCPs.

In addition, automated and standardized processes for porting would increase the likelihood of successful porting and reduce the risk of operational issues. As part of this, it might be worth considering the role third-party service providers could play in facilitating communication and transmission of data in a porting scenario.

## Category 2: Consent Mechanisms

### Client Prior Consent

Some jurisdictions such as the EU require pre-transfer consent from all clients before porting to an alternate CCSP. This makes porting within tight time frames very difficult. Clients that wish to ensure their positions are ported should therefore be ready to provide consent in a timely manner.

### Other Relevant Parties' Consent

Consent might be required from the defaulted member in certain jurisdictions<sup>16</sup>, or the liquidator or trustee, in the event the client still owes funds to the defaulted member or any other bilateral arrangement that the client has with the member to which the CCP might not be privy.

<sup>16</sup> Article 48(6) of EMIR is explicit that consent of the defaulted clearing member is not necessary in the EU

## Potential Mechanisms to Address these Issues

Advance client consent or mechanisms with porting consent as the default (ie, clients must opt out if they object to porting) would be helpful in most cases, and a necessary pre-requisite in other cases to facilitate porting. However, any advance consent mechanism would still rely on the clients having set up an arrangement with an alternate CCSP. In practice, a CCSP will not port in clearing activity from a new client without prior discussion with the client. Absent such pre-existing clearing relationships with other CCSPs, consent of the client and alternate CCSP would still be needed in the EU. This underlines the importance of clients maintaining clearing arrangements with alternate CCSPs if they wish to increase the likelihood of successful porting. As noted in Section 3, one way to increase the likelihood of successful porting is by maintaining several active relationships with CCSPs to allow for the splitting of positions across multiple CCSPs following a default event.

When it comes to backup CCSPs, the CPMI-IOSCO report also suggested that “CCPs and/or industry associations may consider developing a guide to alternative or backup CCSP requirements for clients and CCSPs. Such a guide could consider how the proposed mechanisms would incentivize the establishment of alternative or backup CCSP relationships and how these would affect clients of all sizes. In addition, CCPs and/or industry associations might promote a standardized template agreement that could address information-sharing concerns that arise in conjunction with post-default porting”.

In response to this point, rather than a general recommendation to maintain backup CCSPs, as noted in Section 4, ISDA encourages clients to evaluate how their clearing arrangements affect the portability of their positions. However, there is no single standard solution that can guarantee porting in all circumstances, and porting might not be the most desirable outcome in all situations.

## Category 3: Onboarding Processes

### KYC/AML Checks

KYC/AML checks that are conducted as part of client onboarding are barriers to efficient or successful porting where there is no existing relationship with a potential client, reinforcing the importance of maintaining backup clearing arrangements. KYC/AML checks can take several months in business-as-usual circumstances, and would be virtually impossible to complete within a tight time frame in a porting scenario where the client does not have a pre-existing relationship with the alternate CCSP.

### Due Diligence Requirements

Aside from KYC/AML checks, there are other steps in the onboarding process, as part of due diligence requirements, which also act as a further obstacle to smooth porting.

For example, the due diligence requirements CCSPs in the EU must carry out on their clients follow (EU) 2017/589 (Markets in Financial Instruments Directive II, regulatory technical standard 6), Article 25 (Due diligence assessments of prospective clearing clients), as well as in the same regulation, the requirements for providers of direct electronic access (DEA), in particular Article 22 (Due diligence assessments of prospective DEA clients). In addition, there are, or will be, requirements relating to sustainability risks and climate-related and environmental risks. For example, see expectation 7.5 of the European Central Bank’s Guide on climate-related and environmental risks / Supervisory expectations relating to risk management and disclosure (November 2020): “Institutions are expected to conduct a proper climate-related and environmental due diligence, both at the inception of a client relationship and on an ongoing basis.”

In addition, operational onboarding (setting up accounts, reporting, payments, etc) could act as a barrier to porting.

### Potential Mechanisms to Address these Issues

As summarized in Section 3, the following initiatives may also help to increase the likelihood of successful porting.

For KYC/AML onboarding, one possible solution could allow an interim period in which a CCSP that accepts client portfolios can rely on the defaulted CCSP's KYC/AML checks for as long as compliance is originally performed under a comparable KYC/AML framework. A CCSP could also produce and keep updated data packs with all relevant information about each client and all relevant information for KYC/AML, but this would not necessarily ensure that KYC/AML checks are completed within the porting window, so some temporary relief might be necessary.

However, some CCSPs might not be willing to take on new clients on which they have not completed their own KYC/AML checks. A longer-term solution could involve all relevant CCSPs using a third-party service to perform all KYC checks. Use of existing vendors in the bilateral space could be considered. If a backup clearing arrangement is in place, the KYC/AML checks can be completed prior to the porting scenario arising.

Temporary relief from other due diligence requirements would be necessary, in the absence of backup clearing arrangements.

However, regulatory forbearance would only go so far in addressing onboarding-related obstacles. Alternate CCSP providers might be unwilling to take on a client they have not properly vetted, even if regulators provide the necessary relief. All onboarding-related obstacles further reinforce the importance of clients maintaining alternate clearing arrangements.

Exploring ways to enable clients to continue to pay VM (and additional IM) to the CCP, with the aim of extending the porting window, would help by giving clients more time to arrange for alternate clearing providers in an orderly manner.

## Category 4: Account Structure

### Net Omnibus Accounts

Clients in net omnibus account structures (where collateral and transactions are comingled with those of other clients) would be very hard to port if clients wanted to go to different CCSPs, or if every party within the omnibus account is required to agree to port before this could proceed.

### Porting of Client Collateral

At certain CCPs, following a CCSP's default, the client's collateral would be left with the defaulted member as part of the bankruptcy estate, such that the clients' position would have to be ported with no margin. The client would have to post margin with the new CCSP, while being unable to recoup the margin posted with the defaulted CCSP in short order, leading to double margin requirements. While this should not be an issue wherever individually segregated accounts (ISAs) are used, there is some anecdotal evidence that some clients have had to post double margin to port positions in business-as-usual scenarios, even with ISA accounts.

## Ability for the CCP to Know the Identity of the End Client

Depending on the type of account structure used, CCPs might not know the identity of the end client, making the porting process more challenging, as the CCP cannot proactively assist.

### Potential Mechanisms to Address these Issues

Account structures with greater asset protection and segregation increase the feasibility of successful porting, but come at a higher cost of clearing for clients. This underlines the importance of ensuring clients are aware of the trade-off between cost of clearing and portability. Adequate disclosures around account structures, such that clients understand the impact of their choices on the likelihood of successful porting, are helpful in this respect.

In the EU, Article 39(7) of EMIR does specify that “CCPs and clearing members shall publicly disclose the levels of protection and the costs associated with the different levels of segregation”, including “a description of the main legal implications of the respective levels of segregation”. Article 39(5) of EMIR requires the client to confirm its choice in writing. As summarized in Section 4 of this paper, there is a case for considering non-portability as an option for clients when making choices on account structures.

In addition, the ability to move a client’s collateral might also depend on the type of account structure. In an ISA, it is more likely, though cannot be guaranteed, that the collateral can move in a default event, but it is highly unlikely in a net omnibus account. The ease with which collateral can be moved with positions will be a key determinant of successful porting. Test exercises may also help to identify potential obstacles to moving collateral in a CCSP’s default scenarios.

Where CCPs do not know the identity of their end clients, any solution to ensure that CCPs can have access to this information in business-as-usual circumstances, or that they can at least access this information in a timely manner following a CCSP default event, would help.

## Category 5: Overall Complexity of the Process

While porting positions in business-as-usual circumstances does not pose any particular difficulties for CCPs, porting following the default of a CCSP is a complex process, for all of the reasons explored in this paper. ISDA has also identified additional obstacles that do not pertain to any of the other categories, but add to the overall complexity of the process.

### Issues with Clearing Chains

Depending on regulatory requirements, the affiliate account of the defaulted CCSP could include positions and collateral of clients of the affiliate. It might be unclear what positions belong to the defaulter’s affiliate or clients. Testing exercises on the assumption that a large CCSP at several CCPs defaults would allow this additional layer of complexity to be considered.

### Timing Differences Between Close-out of House Portfolios and Client Portfolios

If the CCP has to run multiple auctions, clients could get worse prices than the house position, which would be closed out first. These timing issues will also cause uncertainty for clients, which over a period of days might not know whether or not their positions will be ported. This uncertainty would also be difficult to hedge. How clients might react will depend on their investment and hedging objectives and might also diverge between OTC and exchange-traded derivatives portfolios.

### Tight Timelines to Complete Porting

The timing question is critical. Further to a default event, CCPs will set a 'porting window', as specified in their rulebook. The porting window is typically very short; a matter of days or even hours. If porting of clients' positions is not completed within that window, the CCP will trigger default management procedures for client positions. From the CCP's perspective, this reinforces the importance of having a clean line of sight to a backup CCSP to increase the likelihood that porting can be conducted in a timely manner, subject to the backup CCSP being able to take on those new positions in these circumstances.

### Potential Mechanisms to Address the Overall Complexity of Porting

The overall complexity of the process underlines the importance of robust bank resolution regimes to ensure continuity of access to clearing, reducing the need to port positions in a disorderly manner, as set out in Section 5.

In addition, as summarized in Section 3, the following initiatives may also help to increase the likelihood of successful porting.

Regular tests, both tabletop as well as real fire drills, for all parties in the porting chain can enhance readiness, ensuring that the CCP has a clean line of sight to a backup CCSP, and can help to identify potential points of tension.

In addition, further harmonization and automation may help. However, there may be challenges with trying to harmonize the processes, operations and rulebooks of CCPs in different jurisdictions and time zones, operating under different legal and regulatory frameworks, and clearing different products. Therefore, any initiative to improve harmonization should consider the differing nature of each CCP to the maximum extent possible, given the global nature of markets.

CCSPs and CCPs could jointly look into operational processes and timelines, ensuring they are realistic, fit for purpose and scalable. It can take up to three months to move exchange-traded and cleared OTC positions in the regular course of business, but CCPs' default provisions typically provide around 24 hours from the default announcement to move positions.

The industry must focus on how technology and vendors can play a role in creating a centralized platform to assist CCPs that have not already developed proprietary platforms in communicating and coordinating default events (eg, client consent, limit monitoring, margin/position transition) to CCSPs and clients.

## 7. APPENDIX: SUGGESTIONS FROM CPMI-IOSCO TO ADDRESS OBSTACLES TO PORTABILITY

### Excerpt from Section 4.2 of CPMI-IOSCO's Report

*In a general overview, in order to identify potential solutions to impediments to portability, CCPs may consider analysing the regulatory framework for each jurisdiction in which they operate, as well as CCP rules, policies, and procedures. In doing so, CCPs may identify possible changes to the applicable CCP rules, policies and procedures that could facilitate porting. To specifically address KYC and AML issues, such industry-led solutions could include using smart contracts and regularly preparing frequently updated KYC/AML data packs.*

*CCSPs and clients would benefit from CCPs providing additional education regarding the roles, responsibilities and risks associated with porting. In particular, CCPs and/or industry associations may consider developing a guide to alternative or back up CCSP requirements for clients and CCSPs. Such a guide could consider how the proposed mechanisms would incentivise the establishment of alternative or backup CCSP relationships and how these would affect clients of all sizes. In addition, CCPs and/or industry associations might promote a standardised template agreement that could address information-sharing concerns that arise in conjunction with post-default porting. A template agreement could take into account applicable regulatory frameworks and stakeholders' need for information to match clients and CCSPs.*

*In addition, CCPs and CCSPs may consider improving the clarity of disclosures regarding the portability risks associated with different account structures. Such work would expand the disclosures to clarify risks other than those typically disclosed to clients about fellow customer risk. Clients would probably benefit from additional information regarding the risks that they face in the porting process and in the event that porting is not successful.*

*Industry stakeholders also may consider what measures could be adopted during BAU to improve communications and coordination in the event of a CCSP default. A CCP may consider what improvements can be achieved regarding coordination between the CCP, its CCSPs, and the CCSPs' clients as well as among CCPs. Such steps may include enhancing and clarifying communication protocols and providing client contact lists to CCPs. It could also extend more broadly to other solutions. Among CCPs, discussions might be helpful on how best to coordinate the liquidation of client positions and address the potential negative consequences of bulk liquidation. As part of this discussion, CCPs may consider the potential effects associated with the notifications of client default, both with regards to timing and the parties notified. Additionally, industry stakeholders might consider taking steps to identify (i) data elements related to porting that can be standardised; (ii) which portions of the porting process that could be automated; and (iii) the types of porting policy and procedures that could be harmonised voluntarily.*

*CCPs may also consider improving readiness for porting by developing more rigorous porting test exercises that go beyond basic operational testing. Such exercises, including joint-CCP exercises, could evaluate the functionality of any direct payment mechanisms from clients to CCPs, the ability of CCPs to coordinate the testing for the porting of the clients of one or more CCSPs defaulting at multiple CCPs, and the feasibility of porting, considering the many identified barriers and constraints. Tests may particularly consider the impact of stressed market conditions, capital limitations at CCSPs and the compressed time frames for porting.*

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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 77 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](http://www.isda.org). Follow us on [Twitter](#), [LinkedIn](#), [Facebook](#) and [YouTube](#).