

Deutsche Börse Group
Response

**to the consultation questions for
comment in the CPMI-IOSCO
discussion paper on central
counterparty practices to
address non-default losses**

Frankfurt, 4th October 2022

A) Introductory Remarks

Deutsche Börse Group (DBG) provides central clearing services for cash, energy, commodity and derivatives markets both for listed as well as certain over-the-counter (OTC) financial instruments through its EMIR-authorized CCPs Eurex Clearing (ECAG) and European Commodity Clearing (ECC).

We welcome CPMI-IOSCO's ongoing efforts to ensure the stability of the broader central clearing model, and, in particular, its contribution to information sharing on non-default losses (NDLs) and industry dialogue on this topic. ECAG also contributed to the CCP survey in January 2021 which informed the analysis presented in the discussion paper. As described in the self-assessments against the Principles for financial market infrastructures (PFMI) and other publicly available disclosures, ECAG and ECC already have a comprehensive framework of resources and preventive measures in place which address NDLs. The CCPs' clearing conditions (including their respective recovery plans) which are contractually agreed to by clearing participants govern the allocation of different types of NDLs. CCPs allocate the losses in ways that are consistent with applicable regulations and preserve the incentive of central clearing for market participants to ensure sound risk management. In our view, loss allocation for NDLs should be proportionate to the level of responsibility and/or the benefits obtained from the service by each stakeholder meaning that CCPs should maintain appropriately sized capital requirements to only cover NDLs for which they are directly responsible. There might be cases where a CCP should be able to disclaim responsibility, including but not limited to losses arising from the failures of third-party custodians and settlement banks.

The PFMI and local regulatory requirements, including the European Market Infrastructure Regulation (Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories, EMIR), require EU CCPs to maintain sufficient financial resources for operational risk, market risk, credit risk, wind-down and business risk. The EU, in particular, is one of the first jurisdictions in the world that has adopted in addition a very detailed CCP Recovery & Resolution Regulation (Regulation (EU) 2021/23 on a framework for the recovery and resolution of central counterparties, CCPRRR). The CCPRRR provides a list of recovery and resolution tools for default and non-default events and the amount up to which they can be used. Notably, the CCPRRR foresees that EU CCPs introduce a second tranche of own resources ("second skin in the game") to be used in both default and non-default scenarios. Furthermore, EU CCPs are subject to detailed guidance for the NDL scenarios to be used as part of recovery planning, including the NDL recovery scenario development process and risks to be covered. In accordance with such applicable legislation, ECAG and ECC have adopted clear pre-established plans including a variety of options for the replenishment of their own funds in the case of NDLs.

Against this background, we believe that ECAG's and ECC's risk management frameworks in relation to NDLs and the underlying regulatory standards are adequate. We do not deem further guidance in this area as advisable and would rather suggest focusing on the monitoring of member jurisdictions' compliance with the existing PFMI framework and progress made in implementing CCP recovery and resolution frameworks. Nevertheless, in case CPMI-IOSCO decides to proceed by developing further guidance, we would recommend taking into account the implementation of the CCPRRR in the EU and review, whether some NDL-related provisions included therein (as detailed below) could be incorporated into an international standard.

B) Comments to the Consultation Questions

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?

No. We believe NDLs are adequately covered by international guidance and, in particular, the EU's implementing rules, and do not consider further regulation on CCPs' practices with regard to NDLs as necessary. Rather, we would welcome, if the standard setting bodies' upcoming policy work focuses on assessing to which extent different jurisdictions have progressed in implementing CCP recovery and resolution frameworks in line with the existing global standards.

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?

With respect to scenarios, the discussion paper states that the non-inclusion of certain types of NDL scenarios (e.g. in relation to custody risk) "appears to be inconsistent" with the PFMI. We do not share the assessment that the PFMI prescribe the design of one or more dedicated NDL scenario for a fixed set of risk types, nor does the EU regulation impose such a requirement. Regulatory guidance on the development of NDL scenarios should allow for a tailored application taking into account the specificities of the respective CCPs and the plausibility of events. Generally, we believe that the NDL scenario coverage by a CCP should be deemed sufficiently precise when the following two conditions are met: (1) The scenarios comply with the applicable regulatory requirements. At EU level, there are various requirements, e.g. under EMIR or Regulatory Technical Standards (RTS) & Guidelines on the CCPRRR. (2) All risks classified as material (according to the CCP's risk inventory) are considered.

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?

Please refer to our response to question 15.

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?

No. In our view, the PFMI which apply to all FMIs provide a sufficient level of guidance for risk management in relation to NDLS. In particular, the EU has adopted dedicated and highly prescriptive regulatory frameworks covering the NDLS caused by materialized risk for specific types of FMIs. For instance, Central Securities Depositories (CSDs) authorized under the EU Central Securities Depositories Regulation (Regulation (EU) No 909/2014 on improving securities settlement in the European Union and on central securities depositories, CSDR) are subject to stringent risk management standards which are based on the principles-based international framework. In addition, some CSDs have obtained banking licenses enabling their customers to draw on short-term credit facilities with a view to increasing settlement efficiency. Such CSDs are required to comply with local banking rules based on the Basel Committee on Banking Supervision (BCBS) standards, e.g. including operational risk capital requirements and Pillar III disclosure requirements. The existing regulation and supervision of CSDs overall reflects their importance to the financial system.

While we do not deem further work on this subject under the PFMI as necessary, we would recommend that any review exercise takes into account the mandatory practices already set out in EU regulation.

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?

Referring to our response to question 2, our understanding is that NDL are caused by the materialization of risks. As the first step, a CCP should have a comprehensive risk management framework in place, including a robust risk identification process. This should include regular reviews of the business environment, material changes within performed processes and respective controls, and the already occurred incidents. A CCP should also maintain a risk inventory providing insights into the risks assessed as material.

The existing regulation on deriving NDL scenarios under EU law overall achieves and supports the identification as well in an appropriate degree of granularity. It is specific enough to guide a CCP properly but also flexible enough to allow a CCP to tailor the application to their specific risk exposure (free choice of methods within the limits of what can be deemed reasonable and appropriate).

For Business-as-Usual, EMIR in conjunction with the RTS 152/2013 set the standard for the calculation of risks being rooted in NDL events. These standards provide clear guidance on the risk types to be integrated, the severity of scenarios, and the expected coverage using EMIR (regulatory) capital. For recovery situations, CCPRRR in conjunction with the respective Guidelines on recovery scenarios (Final ESMA Report) give guidance on the scope of scenarios (including NDL scenarios) and the

expected severity. Taking this into account, we consider a set of NDL scenarios to be comprehensive and sufficiently granular, if:

- the regulatory requirements are met,
- the derived set of scenarios for NDL cover at least every risk type classified as material once (taking into account the business model of the CCP),
- the severity of loss potential is increasing being flooded by the Business-as-Usual-Requirements, raised within the recovery scenarios and being capped by what is deemed being plausible.

If deemed appropriate, CCPs may also consider to voluntarily (unless banking regulated) orient themselves by the internal capital adequacy assessment process (ICAAP) and calculate the operational risk capital, as well as risk capital for all other risk types classified as material, as part of the Required Economic Capital (REC) calculation within the economic perspective.

For operational risk, a scenario analysis method has been implemented – focusing on a 12 months time horizon, i.e. a structured form of assessing the bank's operational risk based on available internal data and expert knowledge.

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?

Existing EU regulations already mandate multiple effective measures. In order to prepare for and to address resulting losses within the recovery and resolution planning requirements (CCPRRR), EU CCPs have to prove sufficient coverage for the comprehensive set of NDL scenarios (see response to question 5). Thereby, CCPs are obliged to have measures in place that address liquidity shortfalls, absorb losses and also enable the replenishment of resources. The minimum regulatory standards are clearly defined. The measures should:

- not foresee usage of initial margins posted by non-defaulting clearing members to provide for loss allocation mechanisms,
- not assume any access to or receipt of extraordinary public financial support, central bank emergency liquidity assistance or central bank liquidity assistance provided under non-standard collateralization, tenor and interest rate terms,
- be selected such that the interests of all stakeholders that are likely to be affected have been considered,
- be legally enforceable within all jurisdictions.

Depending on the type of NDL, various tools and resources may be considered to address it. There are several options at disposal to replenish capital for NDL events such as:

- committed or uncommitted credit lines,
- loss compensation within the group of companies,
- financial commitments or guarantees by parent or group companies,
- issuance of bonds or commercial papers, or

- capital increase by parent company.

The options to address NDIs are reviewed at least once a year as part of the recovery planning process. Part of this review serves to assess the options with respect to their overall effectiveness, financial impact, operational impact, external impact and feasibility per scenario. In terms of NDI events that are solely operational, there is a recovery option in place to ensure the availability of the mission critical functions of the CCP. The goal of this measure is to protect against data loss due to the failure of (systems in) one data center and to ensure the operating stability of the IT systems for the clearing business in a crisis.

Last but not least, irrespective of the type of a loss a CCP might face, it might be obliged to meet various capital requirements defined by the regulatory bodies, depending on the license held (e.g. EMIR capital requirements or Basel/Pillar I&II capital requirements for banking regulated entities). These aim to ensure business viability should the adverse scenarios or incidents materialize.

7. Are approaches such as sensitivity analysis, scenario simulations, drills or stress-testing analysis useful for quantifying resource needs and assessing adequate NDI coverage? If so, what are potential obstacles hampering progress in this area and what could be possible avenues for reducing those obstacles?

Yes, such approaches are generally helpful. EU regulation already provides sufficient guidance on the calculation methods to be used. Again, we would like to highlight, that the existing regulatory guidance accompanied by the industry standards are balanced as they define stringent requirements while also leaving flexibility to reflect the individual situation of every CCP. The assessment of whether the used methods comply with the regulation and can be deemed as reasonable and appropriate will be completed by the internal audit, the external audit and the regulators (competent authorities or recovery authority as well as resolution authority). This ensures a high level of scrutiny.

Approaches to be used for a Business-as-Usual perspective are defined according to Article 16 EMIR in conjunction with RTS 152/2013. The regulatory requirements symbolize a gone concern approach. In addition, and, if deemed appropriate, CCPs may also voluntarily (or mandatorily, if banking regulated) use an economic view based on the ICAAP, by considering all risk types classified as material within the Risk-Bearing Capacity (RBC). The RBC is equal to regulatory own funds (minus adjustments for unrealized losses driven mainly by ongoing litigations, for non-consolidated entities, unrealized losses from securities (Banking Book) as well as for potential further reasons), should be adequately allocated between the material risk types, and should always be sufficient to cover Economic Capital needs for each risk type.

As part of the recovery analysis, it must additionally be demonstrated that the CCP has sufficient measures to mitigate losses that exceed the losses that are observed in the Business-as-Usual environment. However, the type of risk quantification changes due to the regulatory requirements of the RTS. Scenarios are to be used, whereby a scenario is understood as a complete approach, from the description of the economic context to the

explanation of the measures for loss absorption. The requested scenarios under the recovery governance therefore ensure:

- an economic alternative to the RBC, by calculating the risk potential based on scenarios rather than using simulation approaches,
- a sufficient loss-absorbing potential to return to going concern in the event of emerging risks that exceed the requirements of Business-as-Usual.

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)?

Yes, for EU CCPs, like ECAG and ECC, EU regulation already defines the set of NDL scenarios to be covered. These are defined by the following principles:

Business-as-Usual:

- Regulatory view based on EMIR in conjunction with RTS 152/2013 describing the risk to be considered
- Economic view based on the RBC model considering all risk types classified as material within the risk inventory

Recovery:

- For the overall set on NDL scenarios considering all risk types classified as material within the risk inventory
- Reflecting the types of scenarios that are required within the RTS on recovery scenarios (Final Report ESMA)
- Considering the types and sources of risk to be covered by CCP recovery plan scenario according to RTS on recovery scenarios (Final Report ESMA)

The documentation to prove regulatory compliance covers the following steps:

Business-as-Usual:

- Concept on regulatory capital adequacy
- Concept on economic capital adequacy

Recovery:

- Including the types and sources of risk to be covered by CCP recovery plan scenario according to RTS on recovery scenarios (Final Report ESMA) in the risk inventory to prove the consideration by classifying material risk types
- Including evidence within the recovery plan that all risk types classified as material are covered by the total set of NDL scenarios
- Including evidence within the recovery plan that the set of NDL scenarios covers the types of scenarios that are required within the RTS on recovery scenarios (Final Report ESMA)

Additionally, considering the dependence on perfectly functioning systems and the severe external threats to a CCP's operations due to an external disruption, shock or a cyber-related incident, this type of NDL scenario is helpful to assess potential resources and coverage for NDLs.

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

The applicable EU law can serve as an example how the potential simultaneous occurrence of both events can be taken into account: the potential simultaneous occurrence of a default and non-default event is considered in the recovery plan as required by the CCPRRR and the corresponding ESMA Guidelines on recovery plan scenarios. Within the combined scenario, CCPs can test the application of potential mitigating measures to counteract DL and NDL events.

For the modelling of the combined scenario, ECAG and ECC have chosen a combination of a clearing member's default, which is considered highly relevant, and a regulatory fine. This scenario supports the analysis and testing of the recovery indicators and possible recovery options, where both CPPs are facing a clearing member default event and sees itself opposed to idiosyncratic stress.

The above-mentioned scenario foresees that both events are related to a failing Default Management Process (DMP). Following the default of a clearing member, the DMP needs to be executed in accordance with predefined rules and regulations, but still encounters customer complaints or litigation, e.g. regarding (alleged) non-compliance with specific local requirements. In consequence, this leads to a situation that is financially detrimental for the defaulting clearing member or other non-defaulting clearing members. The CCP is faced with claims for compensation from the insolvency administrator of the defaulting clearing member or participants in the auction and respective litigation costs.

The impact and likelihood of financial losses depends on the size of the defaulting clearing member and the severity of the incident. For this reason, the scenario assumptions differentiate major and minor clearing member defaults, as well as minor, medium, major and the "worst-case" incidents.

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 calculation of sufficient liquid net assets funded by equity for recovery and wind-down is already sufficiently defined for EU CCPs. This includes regulatory requirements for Business-as-Usual risk management as well as rules for CCP recovery and resolution planning and wind-down planning:

In the regulatory requirements for EU CCPs for Business-as-Usual risk management (Article 16 EMIR in conjunction with RTS 152/2013), EU CCPs are required to hold capital (held as liquid assets) for an orderly wind-down. This capital is measured by the operating costs necessary to continue business operations for at least 6 months. In a wind-down analysis, it must be deduced in parallel that the wind-down of the business can take place within the regulatory period of 6 months, whereby individual circumstances (general business risk profile) must be taken into account. Should the individual analysis conclude that a longer wind-down period is required, corresponding liquid capital must be reserved based on this estimate and the corresponding operating costs.

The CCPRRR requirements for the recovery of a CCP, going beyond the Business-as-Usual risk management, require the development of individual recovery scenarios, which must reflect the CCP's business profile. The recovery options to be defined must be demonstrably in liquid form, or stretched over existing liquidity, so that a restoration of the CCP's viability can take place.

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)?

On the one hand, such losses are fortunately very rare, and hence, no economic burden has to be considered on a frequent basis. Nevertheless, when aiming to build any valuation model a certain amount of data should be available as a basis. Therefore, the main source of information can only be expert judgement based on the internal data of each CCP.

One of the very often discussed alternatives would be the usage of external data. However, owing to the very specific business model a CCP runs, the data that may be retrievable from other financial institutions may likely not be applicable to CCPs. In addition, such data may likely not be comparable and open to interpretation, as even the term NDL is not always clearly defined. For instance, there may be a question as to whether a single NDL is an estimated worst case loss, a realized loss (after accounting for insurances and mitigations) or whether it includes potential additional costs (legal, recovery effort, etc.).

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?

Given the infrequency of NDLs and the dependence on systems and internal processes, it might be difficult to find approaches to share loss data within the clearing industry.

DBG is open for an industry discussion that might clarify questions on how to leverage loss data from other industries. CCPs can, for example, already leverage operational risk loss data made available by service providers or banking associations. However, the aggregate and average data tend to be strongly driven by unique, bank-specific events.

Furthermore, data from other industries will likely not be fully suitable for the design of CCP (recovery) scenarios which are based on very specific tail risks which to date have not materialized. The use of this data, e.g. for the purposes of calibrating tools and resources to address NDLs, should be at the discretion of a CCP.

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 part of the risk management framework, CCPs should have risk identification and monitoring tools in place, so that any upcoming or increasing risks can be timely identified and appropriate actions taken prior to their materialization.

Risk indicators can be created as an early warning tool for the potential changes within the risk landscape, whereas stress testing is a good approach to measure the impact of adverse incidents on the capital. The RBC utilization should be constantly monitored, and any breaches should be escalated to senior management.

Regarding NDL cases which will trigger recovery, the CCPRRR requires CCPs to include in the recovery plan measures to enable the CCP to replenish financial resources (Article 9 (2) CCPRRR). In doing so, there are several options at disposal to replenish its capital for NDL events (loss compensation by profit and loss transfer agreement, letter of comfort, capital increase by parent company). The options to address NDLs are reviewed at least once a year as part of the recovery planning process. Part of this review serves to assess the options on their overall effectiveness, financial impact, operational impact, external impact and feasibility per scenario.

For potential measures of the recovery plan, an appropriate expertise in the exercise of those recovery options is available. Recovery options were tested through practical application. The current availability of committed or legally binding funding arrangements is also reviewed and assessed on a yearly basis within the recovery plan to have a full picture of the CCPs' potential to make use of these resources.

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 plays an important role as risk mitigating measure and could also be used for NDLs. Insurances can cover losses that are most likely linked to incidents leading to NDL, e.g. directors' & officers' liability, civil liability and crime. However, the use of insurance coverage must be balanced between the scope and coverage of the insurance and the premium a CCP has to pay. In addition, a trend in the financial world can be observed that it is becoming exceedingly difficult (or impossible), even in very limited areas, to obtain insurance coverage (also using syndicated approaches). In other cases where

insurance coverage is still feasible, the premiums to be paid have exponentially increased which raises cost-benefit questions.

But even with regard to insurable scenarios, the consideration of insurance within the risk management or recovery planning must be reasonable and appropriate. Limitations, such as pay-out delays and coverage interpretations or disputes must be taken into account. Therefore, it seems appropriate to use insurance where the insurance premium appears appropriate to the risk. In the risk quantification, however, it seems appropriate to either refrain from considering insurance as a risk mitigation measure at all or to include the risk mitigation in a conservative way such that the mentioned limitations are demonstrably considered.

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

While EU CCPs have developed comprehensive and detailed wind-down plans in accordance with the applicable EU requirements, CCPs could generally consider further operationalizing the wind-down and restructuring process in the form of an internal playbook/guidance.

Achieving operational effectiveness (Section 3)

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

An assessment of the mitigating measures and of the details on the implementation process is carried out on a regular basis by EU CCPs to ensure their effectiveness and timely implementation.

Furthermore, pursuant to Article 9 (19) CCPRRR the recovery plan shall be integrated into the corporate governance and the overall risk management framework of the CCP. The recovery plan contains measures to address NDLS. On the basis of this integration, the recovery plan is tested by leveraging existing testing infrastructure.

In addition to defining and running several testing procedures, CCPs may also consider developing a complementary "playbook" that operationalizes the usage of the recovery plan.

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?

The general rights and obligations with respect to NDLS could be outlined in the CCPs' clearing conditions. It may also be helpful to present these general NDLS-related rights and obligations to a committee where members and clients are represented (e.g. the

EMIR Risk Committee) or to run an open consultation on any material changes to such provisions.

Besides the clearing conditions, and, in order to ensure that third parties understand the impact of NDIs and their own role, CCPs could also consider drafting a dedicated document with a summary of the recovery and resolution tools that address NDIs and that may impact clearing members. This summary could then be provided to clearing members upon request.

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 NDI event?

The term “relevant third-parties” in the context of NDIs may include third parties acting as service providers and third parties acting as loss/liquidity absorbing options. These two categories of third parties need to be distinguished.

Services providers are closely managed under a comprehensive EU outsourcing framework, including risk assessment, exit plan, service definitions statements and defined key performance indicators among other measures. Additionally, a close monitoring under the Business Continuity Management (BCM) is ensured for services providers which are integrated in business-critical processes/services. For third parties in the meaning of external loss absorbing and/or liquidity providers, a specific due diligence should be conducted by CCPs. As part of this assessment, CCPs may consider performing an ongoing credit rating and limit process in order to limit concentration risks as well as the risk of counterparty failure.

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

The factors that impact the choice and order of different tools are to some degree defined in EU regulation. According to Article 9 (6) CCPRRR, CCPs shall include provisions in their operating rules, outlining the procedures to be followed, in order to achieve the goals of the recovery process. In general, the governance processes should be documented and ensure that triggering a recovery indicator or hitting the set threshold signals an event requiring attention by the management board. Based on the recovery indicators and the overall risk situation, the management board can take appropriate action on a case-by-case basis. As any recovery situation will be highly individual, sufficient space for discretionary decision is required (as recognized in the CCPRRR by the EU legislator).

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

As operational NDI events can occur when processes and IT systems do not perform as expected, the use of developed technological tools and IT systems which are not already part of each CCP’s IT security and BCM framework could be limited.

Furthermore, recovery instruments such as cash calls (and position allocation tools for default losses) and the necessary communication are applied via the CCPs clearing systems and established communication processes. While adaptations to the clearing systems are required, there is no need for new IT systems in this context.

An exception might be capital bail-in tools as set out under banking regulation, but the application of such tools is highly specific to each CCP and should be subject to the oversight by the competent regulator. The development of a standardized technological approach for this purpose is not necessary. Another exception may be loss allocation, but even in this case the quantum of losses and maybe even the affected group of clearing participants might differ depending on the details of the loss, which could render integration in IT systems difficult.

Reviewing and testing plans for NDLS (Section 4)

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

Please refer therefore also to our answer to question 16.

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?

Generally, we believe that the processes and channels established by ECAG and ECC, e.g. consultation of the EMIR Risk Committee and member consultations for material rule changes, ensure sufficient involvement of additional stakeholders on the review of risk management and recovery processes, including NDLS.

The involvement of additional stakeholders at the different stages would result in an increasing governance and preparation to enable this involvement. This increasing governance comes along with additional workload (and costs), less so for the CCP, but especially for members active at several CCPs or service providers used by multiple CCPs. Furthermore, it risks undermining the CCPs flexibility and ability to respond to a changing environment in a timely manner.

Another challenge could be confidentiality: the testing would have to anonymize any data that could allow to reverse-engineer confidential information of clearing participants, third parties or the CCP. Another challenge would be testing of plans to address NDLS, if IT security is affected, as many CCPs do not share information about their defenses.

The involvement of external counterparties would lead to substantially different results in a testing environment versus a real stressed scenario. Process and communications testing is possible and should be part of any recovery planning process. However, scenario specific (“end-to-end”) testing with multiple stakeholders would be extremely difficult, might interfere with the productive IT-environment and would only cover a fraction of the

possible risk channels. Therefore, the outcome of such testing is limited (e.g. issuance of shares).

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?

There are few NDL scenarios that can affect multiple CCPs at the same time, such as, for instance, operational issues or defaults at a custodian or payment system. Certain NDLS are very specific to the respective CCPs which also use very different approaches to capital replenishment. For these reasons, we expect the added value of such a joint drill to be rather limited.

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?

CCPs should maintain a regular exchange with the supervisory authorities, including recovery and resolution authorities. Such exchange contributes to transparency vis-à-vis the authority and emphasizes the engagement. Similarly, constant dialogue with participants and other third parties, including via formal mechanisms such as the EMIR Risk Committee, is also key to ensuring effective governance, transparency, and engagement.

The above-described exchanges and communication channels can also be used in the case of an NDL event.

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?

CCPs should have arrangements in place to ensure that clearing members can anticipate and prepare for potential exposure.

The respective issues could be addressed as part of the CCPs' clearing conditions. Any subsequent material change to the clearing conditions with respect to NDLS could then form part of an open member consultation prior to its entry into effect.

Besides addressing the topic in the clearing conditions, and, in order to ensure that clearing participants understand the impact of NDLS and their own role, CCPs could consider drafting a dedicated document with a summary of the recovery and resolution tools that address NDLS and that may impact clearing participants. This summary could then be provided to clearing participants upon request.

Finally, specific governance committees enabling member participation, such as the EMIR Risk Committee, could be used to inform about relevant changes and the potential impact.