



**Response: CPMI-IOSCO Discussion Paper on client clearing:  
access and portability**

## **Background**

The World Federation of Exchanges (WFE) is the global trade association for regulated exchanges and clearing houses. We represent over 250 market-infrastructures, spread across the Asia-Pacific region (~37%), EMEA (~43%) and the Americas (~20%). with everything from local entities in emerging markets to groups based in major financial centres. Collectively, member exchanges are home to nearly 53,000 listed companies, and the market capitalisation of these entities is over \$95 trillion, while the 50 distinct CCP clearing services (both vertically integrated and stand-alone) collectively ensure that traders put up \$1 trillion of resources to back their risk positions.

With extensive experience of developing and enforcing high standards of conduct, WFE members support an orderly, secure, fair and transparent environment for investors; for companies that raise capital; and for all who deal with financial risk. We seek outcomes that maximise financial stability, consumer confidence and economic growth. And we engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in an internationally integrated financial system.

If you have any further questions, or wish to follow-up on our contribution, the WFE remains at your disposal. Please contact:

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## **Client Clearing: Access and Portability**

The WFE appreciates the opportunity to respond to the CPMI-IOSCO discussion paper on client clearing: access and portability. We welcome the regulatory authorities' aim to further inform the marketplace about alternative access models for central clearing and existing best porting practices rather than prescribe further guidance on the Principles for Financial Market Infrastructures (PFMIs)<sup>1</sup>, which, in our view, have proved themselves effective in addressing client clearing, particularly with respect to porting. We also do not believe it would be feasible to prescribe more granular guidance given the differences across jurisdictions and central counterparties (CCPs).

As regards to the key themes put forward for discussion in the CPMI-IOSCO paper we have the following general comments:

## **Access**

Alternative access models could contribute to the reduction of concentration in client clearing and diversify the base of a CCP's direct clearing participants. Such models have the potential to facilitate greater direct access to clearing for market participants, bringing the benefits of central clearing as well as mutual economic, risk management and operational benefits to them.

We understand that a wide variety of new access models could mean that participants have different approaches to consider in accessing central clearing, including if they should continue to access clearing under the traditional intermediation model. In the first place, it is important for participants in clearing to be conscious of all aspects of what they are undertaking. Secondly, CCPs should be able to design alternative models that best suit their client base and the legal/regulatory framework they operate in.

## **Porting**

Portability is essential to providing the continuity of clearing where a client clearing service provider (CCSP) defaults, which in turn ensures the continuity of risk management, with benefits to both clients and reducing uncertainty in the financial system and maintaining netting. In that sense, we support practices that prioritise facilitating efficient and successful porting.

As recognised by the discussion paper, though not giving an assurance for the porting of clients, 'game plans' that are designed to prepare the CCPs for clearing member defaults would contribute to increasing portability and mitigating the impact of a clearing member default on the CCPs and the financial system. In jurisdictions where express client consent is not required for porting and CCPs have a gross margin account structure, many CCPs undertake a pre-emptive analysis of their clearing member base to determine their capital position, product portfolios and the type of clients they serve, and then identify the best potential matches between clearing members which could take on other members' portfolios in the event of a default. As part of their business-as-usual risk management practices, CCPs also actively monitor clearing member profiles to understand changes in clearing member exposures, capital and client base, which would be important for 'game plans' to be viable. Maintaining such 'game plans' allows authorities and CCPs to act quickly when a clearing member is in distress and attempt to arrange the porting of portfolios, ideally before default has been reached. There are past examples of such measures being successfully implemented by CCPs.

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<sup>1</sup> [CPMI-IOSCO: Principles for financial market infrastructures, April 2012](#)

Under a net omnibus account structure where the CCP manages its new exposure to clearing members, however, it is unlikely that the CCP would not have sufficient information to accurately attribute positions and collateral to specific clients of the clearing member to facilitate porting.

We would like to emphasise that efficient and successful porting is not only dependent on internal measures taken by the CCPs. A supportive regulatory and legal framework is crucial to the porting process. As recognised in the CPMI-IOSCO discussion paper, the regulatory and insolvency regimes in some jurisdictions have key tenets which facilitate the prompt porting of positions. Therefore, we believe that, rather than only looking to CCPs to improve their porting practices, regulatory authorities should consider the lifting of existing regulatory barriers that could impede successful porting.

Regulatory relief in terms of certain know-your-client (KYC), anti-money laundering (AML), capital requirements for clearing members, and relying on deference to the home country regulator of the jurisdiction of the client, could also enhance the likelihood to successful porting.. Survey results presented in the report show that the majority of CCPs and CCSPs have indicated KYC and AML requirements as barriers to porting.

Further, the WFE would like to pick up another finding of the report. The international standard-setting bodies identified that client consent mechanisms differ across jurisdictions. Local regimes that require explicit positive ex-ante client consent are a hurdle reducing the likelihood of successful porting. Therefore, we concur with the report that it is worth considering “(i) creating a protocol to contact clients to the extent that consent is needed; and/or (ii) exploring when consent can be given contractually in advance, in order to facilitate porting”<sup>2</sup> These changes will allow for the potential “bulk transfer” of client positions without the delays associated with obtaining express affirmative consent of the client, which increases the chance of successful porting.

## **Communication and coordination**

Transparency and coordination are areas that can benefit the porting process but we note there are limitations to how much transparency a CCP can provide before encountering confidentiality issues. There are also natural limits to the extent to which porting can be coordinated across CCPs operating under different rules and frameworks, as well as given inherent differences in products cleared, clearing membership bases, and primary market hours, among other factors.

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<sup>2</sup> CPMI-IOSCO, [A discussion paper on client clearing: access and portability](#), (Please see p15, 3. Client Consent)

## Response to questions:

**Q2. Could there be any other solutions that would facilitate access, either through greater use of such access models by small and medium-sized clients, or through some other solution?**

We believe there is scope for alternative access models described in the paper (e.g., sponsored and direct access) to facilitate some clients' access to clearing, including small and medium-sized clients. However, we acknowledge that access models are currently used more by larger clients, but support further efforts to facilitate access to risk management tools. It is important to note, however, that some access models were designed to address risk and resource management constraints in relation to client clearing rather than for specific types of clients. The greater use by larger/more sophisticated clients is thus, in part, a natural consequence of the above-mentioned constraints. Greater use by different types of clients will depend on the individual asset class, regulatory frameworks and evolution of access models, among other factors, but also on the demand by different types of clients. Different CCPs, may find it beneficial to experiment with access models and jurisdictional legal and regulatory frameworks should not inappropriately prevent this, where the CCP can properly manage the associated risks.

**Q5. Do you think that CCPs have introduced sufficient safeguards to prevent risk transmission from direct participants using direct and sponsored access models? Why/why not? If not, what additional safeguards do you think are necessary?**

We believe CCPs have installed robust safeguards to prevent undue risk transmission relating to direct and sponsored access models.

When developing access models, CCPs have installed specific safeguards in coordination with market participants. As the risks in relation to direct access by clients are comparable in some ways to those arising from standard clearing membership, CCPs have ensured high risk management standards for direct/sponsored access. For example, a sponsor may take over the obligation for its clients to provide the default fund contributions, to participate in the default management process and/or to take care of daily settlement of payment and delivery obligations. Furthermore, many CCPs have installed safeguards in the form of sponsor guarantees or in the default waterfall to cater for a default.

As set out in Principle 4 of the PFMI<sup>3</sup> a CCP has the obligation to “measure, monitor and manage its credit risk exposures to participants” and “should maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.”

CCPs are at different stages in the introduction of access models. Although practices across jurisdictions may vary, the PFMI provide a solid basis for the establishing of robust safeguards at CCPs, including with respect to direct and sponsored access models. We do not believe that additional prescriptive standards are necessary at the international level.

**Q8. Do you think that CCP rules adequately address the issue of sponsor default? If so, what are the CCP rules that adequately address this issue? If not, what kind of CCP rules are required to address this issue?**

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<sup>3</sup> [Principle 4: Credit risk, page 36](#). Please also see Principle 3: Framework for the comprehensive management of risks, page 32.

Generally, CCPs carefully plan for the default of clearing members and specifically test against the default of their largest clearing members in accordance with PFMI recommendations. As alluded to in our answer to Q5, there are special considerations that apply with respect to the direct and sponsored access models. CCPs offering direct or sponsored access models have rules in place that address the issue of sponsor default in ways that are sufficient and tailored applicably to their own scenarios.

CCPs are at different stages in the introduction of access models. While there may be a place for sharing of best practices, prescriptive standards would be inappropriate given the diversity of regulatory frameworks and the solid basis the PFMI otherwise provides for CCPs to develop such models in a robust and effective manner.

**Q13. Please provide additional comments with regard to access to client clearing more generally.**

Besides access to client clearing, one of the challenges that inappropriately high regulatory barriers pose is the concentration of client clearing service provision. We believe that the alternative models described in the CPMI-IOSCO discussion paper can help address risk and liquidity management constraints by market participants and provide a broader access to the benefits of central clearing. As mentioned above, greater use by different types of clients will depend on the individual asset class, regulatory frameworks and evolution of access models, among other factors, but also on the demand by different types of clients based on their risk and liquidity management needs. The WFE and its members look forward to continually evaluating the efficacy of regulatory reforms against the ability of clients to access clearing.

Furthermore, in the cross-border context, too broad registration requirements in the relevant jurisdictions could potentially undermine the incentives of parties – clients, CCSPs, and CCPs – to facilitate client access to central clearing, either through a traditional client clearing or sponsored access models. In this context, to facilitate access of clients to clearing, it would be desirable that the client’s home country regulator takes a deferential approach **to offshore CCPs and CCSPs clearing for clients in its jurisdiction** to the maximum extent possible by recognising and deferring to the supervision and regulation of the home country regime.

**Q15. Potentially effective practices. Do you agree with the two tools identified in the discussion paper as potentially successful porting practices? Are there any other tools that should be identified as potentially effective practices?**

Regarding the approach described in **3.1.1. Alternate CCSPs for clients of defaulted CCSPs**, we agree that the pre-emptive analysis of CCSP portfolios to identify those CCSPs that are most likely to accept client portfolios of defaulting CCSPs in the form of ‘game plans’ that are designed by CCPs could be potentially successful porting practices. However, it should be noted that under local regimes that require client consent, alternative CCSPs cannot be identified by the CCP but depend on clients’ choice. ‘Game plans’ are especially useful for the CCPs’ ability to be able to act quickly and facilitate the prompt and successful porting of client portfolios. As noted above, successful porting is essential to the default management process as it provides for continuity of clearing and thereby reduces uncertainty in the financial system and enables the maintaining of netting. Nevertheless, under local regimes requiring client consent, it is unlikely that ‘game plans’ are successful as the CCP cannot anticipate the decisions taken by the clients. Therefore, we agree with the report’s finding that there are different regulatory requirements defining the applicability of such practices.

Regarding the approach described in **3.1.2. Account structures that facilitate clients maintaining fully margined positions**, we would note:

- 1) In our view, gross margined account structures at the CCP level make it easiest for porting to happen as clients' risk calculations are done individually, such that each client's exposures are independently fully margined at the CCP-level and not offset against other unaffiliated client's exposures. In terms of segregated account structures, it is important to clearly segregate the client's margin from the CCSPs' house margin, i.e. the collateral that covers the CCSPs' own positions, rather than the positions of their clients.
- 2) For net margin account structures, on the other hand, a CCP typically establishes omnibus accounts that hold the positions for multiple clients of a clearing member. This account structure allows the CCP to manage its net exposure to the clearing member but generally does not provide the CCP with sufficient information to accurately attribute positions and collateral to specific clients of the clearing member. Accordingly, it is unlikely that a CCP operating under such a regime could identify the positions of all of the customers held in each omnibus account, attribute collateral to such positions, identify a clearing member willing to receive the positions of each customer and transfer such positions in a time frame that is acceptable from a risk perspective.
- 3) In terms of client consent, we support both the introduction of "a protocol to contact clients to the extent that consent is needed" and "exploring when consent can be given contractually in advance, in order to facilitate porting"<sup>4</sup>. These changes will allow for the potential "bulk transfer" of client positions without the delays associated with obtaining express affirmative consent of the client, which increases the chance of successful porting. We note that if clients do not agree with the CCSP they have been transferred to by the CCP, they are able to switch to another CCSP of their own choosing after the initial porting.

**Q16. What additional approaches do CCPs use to pre-emptively identify a backup CCSP? What incentives can be provided to assist the development of alternative/backup CCSP relationships? Are there any other considerations for alternate/backup CCSPs not set forth in the report?**

Identifying an alternate CCSP, including through the game plan process, at an early stage is important to increasing the likelihood of a successful porting process. There are a number of techniques CCPs already apply to allow clients to identify alternate CCSPs. CCPs also invite CCSPs and where relevant, clients to take part in regular fire drill exercises that they undertake.

One persistent issue in identifying alternate CCSPs may be concentration, which is particularly acute in emerging markets that may be limited to domestic CCSPs. Therefore, these jurisdictions, as well as others more broadly in the name of the benefits of diversification, would benefit from greater international participation in their clearing ecosystems. Facilitating mutual regulatory recognition, as well as QCCP status for emerging markets can assist in the entry of additional CCSPs.

Another matter that might prevent a CCSP from accepting clients for porting that is closely linked to current regulatory requirements, including with respect to KYC and AML provisions, as alluded to in the discussion paper. This could render a swift process of a CCSP accepting clients in case of a default

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<sup>4</sup> CPMI-IOSCO, [A discussion paper on client clearing: access and portability](#), (Please see p15, 3. Client Consent)

challenging. Therefore, as we noted above, temporary regulatory relief for capital, KYC and AML requirements for the porting phase may prove useful in further enhancing the likelihood of porting.

Another issue is the costs for clients (especially small and medium-sized clients) arising from the need to maintain multiple relationships to clearing members to ensure an alternate CCSP for the porting phase (i.e., described in Section 3.1.1(i) of the discussion paper), which is not a feature of the 'game plan' approach. Maintaining relationships can be important given that, in case of a default, clearing members may only accept clients they already have established relationships with. However, even a standing relationship does not necessarily guarantee that the designated alternate CCSP will take on the client's business. Such decision may rather depend on the alternate CCSP's risk appetite, and financial and operational resource capacities, etc. This is also closely linked to the current regulatory requirements such as strict client consent, as described in our response to Q21.

**Q21. What is your view of a client consent mechanism that could be used to facilitate porting, if permitted under applicable law?**

The international standard-setting bodies have rightly identified that client consent mechanisms differ across jurisdictions and that local regimes that require positive ex-ante client consent are a hurdle reducing the likelihood of successful porting in the porting period. As mentioned in our answer to Q15, we therefore concur with the report that it is worth considering revising local client consent mechanisms for an introduction of "a protocol to contact clients to the extent that consent is needed" and "exploring when consent can be given contractually in advance, in order to facilitate porting"<sup>5</sup>. These changes allow for the potential "bulk transfer" of client positions without the delays associated with obtaining express affirmative consent of the client, which increases the chance of successful porting.

**Q24. Are there any additional communications by the CCP or the defaulting CCSP that may increase the probability of porting client accounts?**

All defaults are idiosyncratic and the timing and content of communication during the default management process is important to its successful completion. CCPs make information available regarding the description of porting processes and necessary requirements, particularly through their rulebooks, and invite CCSPs and where relevant, clients to test those processes to facilitate market participants' preparedness. CCPs have also established communication procedures with clearing members and clients in case of a defaulting CCSP. CCPs must have flexibility in how and what they communicate with CCSPs, default management action participants, and the wider market community and public, so that communications do not undermine CCPs' abilities to effectively manage the default and proper incentives are maintained during the default management processes. It is also appropriate that CCPs have open and transparent communication with their primary supervisory authority.

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<sup>5</sup> CPMI-IOSCO, [A discussion paper on client clearing: access and portability](#), (Please see p15, 3. Client Consent)