

11 October 2013

CPSS Secretariat
Committee on Payment and Settlement Systems
Bank for International Settlements
Sent by email: cpss@bis.org

IOSCO Secretariat
Technical Committee
International Organization of Securities Commissions
Sent by email: fmirecovery@iosco.org

Re: CPSS-IOSCO Consultative report: Recovery of financial market infrastructures

Dear Secretariat:

This letter contains the response of the International Swaps and Derivatives Association¹ (“ISDA”), the Institute of International Finance Inc. (“IIF”) and The Clearing House (“TCH”) (together, the “Associations”) to the Committee on Payment and Settlement Systems (CPSS) and International Organization of Securities Commissions (IOSCO) (together, “CPSS-IOSCO”) consultative report, *Recovery of financial market infrastructures* issued for comment on 12 August 2013.

Effective recovery, continuity and resolution mechanisms for financial market infrastructures (FMIs) are critical to the efficient operation and sustainability of the financial markets. We appreciate the guidance provided within the consultative report related to recovery of FMIs and desire to provide meaningful response to ensure a viable framework is adopted. Our response focuses on central counterparties (CCPs) which will arguably become the most systemically relevant infrastructure in the financial markets as a result of regulatory reform already enacted.

Systemic risk reduction and financial market resilience is reliant on the robustness of the CCP and the prevention of contagion risk due to a suboptimal recovery or resolution process that could instigate the default of additional clearing members (CMs) or CM clients. This requires a CCP recovery and resolution process that contains mutualisation and limited liability for clearing participants with respect to their CCP exposures.² Any loss allocation mechanism must be equitable and fair and apply equally to all clearing participants at the beneficial owner level and further ensure that any burden placed on remaining clearing participants does not increase systemic risk. Although the primary goal in a default situation should be recovery and continuity of the CCP, the need for resolution cannot be excluded and therefore resolution mechanisms must also be in place. The overall recovery and resolution framework should be designed to avoid creating moral hazard on the part of CCPs and ensure, in the event of CCP insolvency, following application of the recovery and resolution framework, an economic outcome no less fair than that which would apply in a general CCP insolvency liquidation proceeding (i.e. no creditor is worse off). We support that it is inappropriate for taxpayers to be exposed to any residual losses in the event of a CCP insolvency.

¹ A description of the Associations is included within the Appendix.

² Throughout this response, we use the term “clearing participant” to capture the full range of entities who may have direct or indirect exposures to CCPs by virtue of their cleared positions. CMs are a subset of clearing participants each of whom, in addition, unconditionally guarantees the performance of those participants it has as clearing clients, and provides a limited guarantee in the form of default fund contributions that are highly expected to assure, but not guarantee unconditionally, the performance of other CMs and their respective client guarantees.

We welcome the consultative report as an objective and thorough assessment of the various recovery mechanisms and tools that could be utilized at the end of the CCP default waterfall.³ We support assessment powers and variation margin gains haircutting (VMGH) as the most effective mechanisms to allocate losses related to a participant default, and, in the sections that follow, detail why other mechanisms are less appropriate or should not be considered altogether. With regard to recovery tools for liquidity shortfalls and replenishment of financial resources, we are broadly supportive of the mechanisms proposed within the consultation; however, as described within, we acknowledge that CMs may face certain constraints in providing such services. We have significant reservations over the practicality of certain tools contemplated to re-establish a matched book, notably position-based allocation, which we've detailed in the sections that follow.

The overall recovery framework must consider a CCP's default management process, be clearly defined and well understood by all clearing participants, and contain sufficient flexibility to ensure voluntary mechanisms are employable prior to the application of potentially less effective and disruptive mandatory tools. For any mechanism or tool to be effective, it must demonstrate the ability to promote economic incentives, encourage participants to assist the CCP in its risk management and recognize the applicable legal, capital and accounting frameworks. Because CCPs operate in multiple jurisdictions and clear various types of products, the appropriateness and sequencing of certain mechanisms and tools may vary; therefore it is important that various mechanisms and tools be available. Resolution mechanisms should commence only after a CCP's default resources have been exhausted and its default management process is determined ineffective and the CCP is faced with potential insolvency.

We acknowledge that a disorderly default management or recovery process could instigate significant market disruption; therefore, it is critical to ensure that any measures to prevent a foreseeable default and ensure an effective recovery process are employed. It follows that the potential for such a scenario should be already considered when evaluating the appropriateness to mandate certain products for clearing. Where such assessment determines that a product is difficult or likely unmanageable, particularly in a default scenario, the product should not really be cleared to begin with, and certainly clearing participants should not be forced to clear such product.

It is accepted that scenarios may arise where loss allocation mechanisms are deemed ineffective, and absent any further voluntary mechanisms, CCP service termination, and, where the clearing service is full recourse to the CCP, resolution must ensue.

ISDA CCP Loss Allocation at the End of the Waterfall technical paper

In recognition of the significant complexity to achieve an optimal framework, we have engaged industry participants to outline key principles (described in Section I below) and practical mechanisms that respond to stated objectives, reflect risk management practices, and are sensitive to the legal and accounting frameworks of clearing participants and CCPs.

In August 2013, ISDA published a technical paper, *CCP Loss Allocation at the End of the Waterfall*, which analyzes the various recovery mechanisms and tools that can be utilized at the end of the CCP default waterfall.⁴ For example, the technical paper advocates VMGH as the most effective credit loss allocation solution, in that it will effectively cover losses, preserve netting sets, does not create unquantifiable potential liabilities, corresponds to the principle of no party worse off than in liquidation, creates the right incentives among clearing participants to assist the CCP to risk manage the defaulted CM's positions, and is economically viable. The technical paper largely informs our comments throughout and is attached as part of our response to the consultation.

³ The default waterfall refers to the financial safeguards available to the CCP to cover losses arising from a CM default ("Default Losses") and the order in which they may be expended, while end of the waterfall refers to situations following the exhaustion of all such financial safeguards. There are also situations where a CCP's financial safeguards and any minimum CCP capital requirements may be exhausted that are unrelated to a CM default ("Non-default Losses" or "NDL"). Such situations including any recovery or resolution mechanisms should be viewed differently from those that would apply for Default Losses (See Section VI).

⁴ CCP Loss Allocation at the End of the Waterfall, ISDA August 2013. Available at: http://www2.isda.org/attachment/NTc5Nw==/CCP_loss_allocation_waterfall_0807.pdf

I. Key Principles to ensure an effective and viable recovery framework

The consultative report outlines important considerations and numerous available solutions; however practical application of certain mechanisms and tools may render certain methods nonviable. We support the guidelines for appropriate recovery tools suggested in Section 3.3 which detail many of the requisite characteristics of an effective recovery framework; however we believe that each should be further measured against certain fundamental principles.

We suggest the following *Key Principles* be considered when evaluating each recovery mechanism:

1. Liabilities of clearing participants must be predictable and limited. No entity can support nor would be authorized by its regulator or management to participate in an activity where exposures are uncontrollable and either unlimited or unquantifiable.
2. Recovery and continuity mechanisms must be economically viable for all categories of clearing participants, that is, both direct and indirect participants as well as the CCP itself. Mechanisms should be at least consistent with the economic result that each type of clearing participant would experience in a general CCP insolvency proceeding (i.e. no creditor is worse off).
3. Recovery and continuity mechanisms must not challenge accounting criteria to net cleared exposures for financial statement and regulatory capital purposes. Where the specific requirements are not demonstrated, cleared exposures would need to be reported on a gross basis, thereby defeating the purpose of central clearing and consequently render clearing nonviable.
4. A recovery framework must encourage and create incentives for clearing participants to participate in CCP default management practices (e.g. providing risk-offsetting positions to the CCP, or participating in the auction process). Any circumstances of discretion or uncertainty would frustrate such incentives and the overall viability to the recovery framework.
5. Transparency and certainty must exist for clearing participants related to the (i) nature and operation of the default management process and default waterfall, (ii) nature of loss allocation in all circumstances including the exhaustion of the default waterfall, and (iii) relevant decision makers (i.e. Risk Committee, CCP management) at each step of the default management process and any recovery and resolution measures.
6. Recovery, continuity and resolution mechanisms should be designed to avoid creating moral hazard that may compromise risk practices of the CCP itself. These mechanisms should not in any way insulate the board and senior management of the CCP (or its holding company) from the consequences of losses resulting from inappropriate risk-taking by the CCP.
7. Recovery plans should allow for the resolution of any non-critical functions if determined necessary for critical functions to continue. This would further help define clearing participants' liability, by placing a greater emphasis on continuity of critical functions and their restoration to viability.

II. Accounting Criteria to net cleared derivatives

To net cleared exposures for financial statement and capital reporting purposes, clearing participants must adhere to the relevant accounting guidance per their applicable generally accepted accounting principles (GAAP).⁵ Primary accounting guidance requires that entities have transactions against an identifiable party with whom they have a legal right to offset (thereby, the "principal counterparty") and that exposures to a principal counterparty are determinable.⁶ For the purposes

⁵ For purposes of this response, the term "accounting guidance" refers to accounting criteria to net cleared derivatives per the GAAP applicable to the clearing participant (i.e. U.S. GAAP, IFRS etc.).

⁶ FASB Interpretation No. 39 states that "it is a general principle of accounting that the offsetting of assets and liabilities in the balance sheet is improper except where a right to setoff exists." A right of setoff exists when all of the following conditions are met: (a) Each

of this letter, we have focused on netting of cleared derivatives, although note that the principles and considerations would apply equally to other cleared financial assets and financial liabilities (e.g. reverse repurchase and repurchase agreements).

We outline the following *Accounting Criteria* to be considered when evaluating each recovery mechanism and suggest that these criteria be further reviewed in collaboration with the audit firms.

1. Determination of the CCP as principal counterparty: Currently, for almost all CCPs, CMs consider the CCP to be their principal counterparty for their proprietary (i.e. house) positions when determining to which entity they have exposure. Such an assessment is of key relevance in the ability to net cleared derivative exposures for both financial statement and capital reporting purposes as netting is only applicable to transactions with a principal counterparty. The method of loss allocation is determinative in this assessment as it is indicative of whether the clearing process results in loss mutualisation and transformation of the reporting entity's credit risk as opposed to facing a bilateral counterparty prior to clearing. Recovery mechanisms that either allocate losses or close-out open trades on a basis that is dependent on which parties originally transacted with the defaulting CM prior to novation to the CCP or seek to identify participants which have offsetting risk positions against the defaulting CM, call into question, whether the CCP is the principal counterparty and consequently the loss mutualisation and credit risk transformation benefits of the clearing model.
2. Ability to define a netting set with the principal counterparty: Once the CCP has been determined the principal counterparty for CM proprietary positions consideration must be given to whether there is an identifiable and justified netting set for both accounting and regulatory capital purposes. As further detailed in the following section, we are concerned that some of the proposed recovery mechanisms could challenge the ability to define a netting set (e.g. partial or selective tear-up of a subset within a netting set) and thus assess "determinable amounts".
3. Consideration of CMs' role in clearing indirect participant trades: For GAAP purposes, some CMs have determined that they act as either legal agent or in substance agent for the indirect clearing participant with the result that the CM does not reflect back-to-back derivative trades (i.e. between themselves and the indirect clearing participant and themselves and CCP). Recovery mechanisms that effectively result in the CM absorbing losses on behalf of indirect clearing participants or otherwise shielding them from being exposed to such losses could challenge this assessment and result in the CMs regarding themselves, for accounting purposes, as principal to both sides of the trade.

III. Analysis of recovery tools to allocate uncovered losses caused by participant default

With consideration to the guidelines for appropriate recovery tools suggested in Section 3.3 of the consultative report as well as the *Key Principles* and *Accounting Criteria* described in the above sections, we analyze below each of the recovery tools to allocate uncovered losses caused by a participant default listed in Section 3.5 of the consultative report.

At the outset we advocate VMGH as the last stage of a CCP's default waterfall as the most effective recovery and continuity mechanism to achieve the objectives stated within the consultative report. Moreover, VMGH appropriately respects each of the *Key Principles* and *Accounting Criteria* described within this response and is consistent with insolvency measures that would otherwise be applied.

We believe that various recovery mechanisms should be accessible, however, for reasons supported within, certain mechanisms should be considered nonviable.

of two parties owes the other determinable amounts, (b) The reporting party has the right to set off the amount owed with the amount owed by the other party, (c) The reporting party intends to set off, (d) The right of setoff is enforceable at law. IAS 32 paragraph 42 states 'A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity (a) has a legally enforceable right to set off the recognized amounts; and (b) intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously.'

Cash calls on participants (“assessment powers”): We agree that predefined, limited and quantifiable assessment powers are an important and effective component of the default waterfall. As a potential shortfall could be uncontrollable, unlimited and unquantifiable, an important issue that we believe must be addressed, it is appropriately required that assessment powers be predictable, measurable and transparent as supported in paragraphs 3.5.3 and 3.5.7 of the consultative report. When predictable and transparent, assessment powers are another effective recovery tool that create default management incentives and rightly take into account the above *Key Principles*.

To the extent that assessment powers are allocated on a pro-rata risk basis which ensures loss mutualisation across all CMs and is not with reference to the CMs which originally faced the defaulting member on their trades or to CMs with offsetting risk positions for the defaulting members trades, we consider that assessment powers are not in conflict with accounting guidance to net cleared derivatives for financial statement or regulatory capital purposes. For these reasons, predefined, limited and quantifiable assessment powers are already part of the default waterfall of many CCPs.

Variation margin gains haircutting by CCPs: We believe that VMGH is the most viable loss allocation measure and effectively responds to guidelines suggested in the consultative report (Section 3.3) as well as the *Key Principles* and *Accounting Criteria* outlined above. We further advocate the inclusion of VMGH as the last layer of a CCP’s default waterfall to ensure the default management process is transparent and predictable, rather than subject to the discretion of a resolution authority.

Including VMGH as the last layer of the default waterfall incorporates a recovery mechanism into a CCP’s default management process prior to the application of less effective and potentially disruptive mandatory tools. Further, VMGH is consistent with CCP insolvency measures that would otherwise be applied in a default scenario but can be utilized as a recovery, rather than resolution, mechanism. As a result, where it is understood that full contract tear-up or service closure will ensue (as would be dictated by requisite *Accounting Criteria*), VMGH would encourage all clearing participants to engage actively in the default management procedures and to bid aggressively in the auction process. Therefore, VMGH aligns well with stated guidelines that “... recovery tools should be designed to provide appropriate incentives for owners and participants. In particular, they should provide incentives for **surviving participants to assist the FMI in its default management process**” (paragraph 3.3.2; emphasis added). VMGH is also well aligned to a key reference within the consultative report:

In contrast to the use of mandatory tools, voluntary or auction-based sale or replacement of unmatched positions is likely to lead to a far more desirable outcome. Accordingly, to maximize the chances of a successful voluntary or auction-based approach, the CCP should make use of the tools described in previous sections, such as variation margin haircutting and assessment rights, so that it has significant additional resources over and above its pre-funded default resources before it is forced to employ mandatory tools such as tear-up of contracts or forced allocation. (paragraph 3.9.24; emphasis added)

As the cumulative sum of clearing participants’ VM gains since a CM default would always be sufficient to cover the defaulted CM’s market-to-market losses in the same period, VMGH would allow a CCP to *distribute all losses pro-rata* to unpaid gains at the beneficial owner level.⁷ Given that the proposal is to apply VMGH after the determination of the net portfolio of the CM, we consider that this should allow for an assertion of “determinable amounts” for purposes of US GAAP netting and an identifiable population of trades to which netting applies (subject to all other netting criteria being met) under IFRS. This process would appear to be consistent with the requisite *Accounting Criteria* outlined above and therefore should not undermine a CM’s ability to net its proprietary positions for financial statement and regulatory capital purposes. Application to indirect participants, however, requires further consideration and should be determined separately from VMGH applied to transactions that the CM has cleared on behalf of indirect participants. Lack of distinction could lead to a CM absorbing losses on behalf of its indirect participants, effectively shielding them from losses and therefore challenge the assessment that some CMs have made that their role in clearing client trades is in substance that of an agent (See Section II).

⁷ VMGH is applied at the beneficial owner level, on a portfolio basis, without cherry-picking the beneficial owner’s in-the-money positions from their out-of-the-money positions. The description in paragraph 3.5.15 suggests otherwise, and is incorrect. Such potential for cherry-picking would break participant’s ability to carry and reserve for positions on a net basis.

In the remote circumstance that the default waterfall, including VMGH, were insufficient to cover the mark-to-market losses and the transfer cost implied as a result of the portfolio auction process, or where the CCP were not able to determine a market clearing price for that portfolio, the CCP and its CMs must assess whether there exist any other mechanisms to manage or reduce the risk, otherwise full tear-up of the applicable CCP service line must ensue.

The ISDA technical paper *CCP Loss Allocation at the End of the Waterfall* describes in greater detail how VMGH works in practice, the scenarios in which VMGH may no longer be effective and when resolution authorities should step in.

Initial margin haircutting by CCPs (IMH): We believe that IMH is a less effective and predictable recovery mechanism that is incompatible, individually or collectively, with certain legal, regulatory, accounting and capital frameworks, thereby casting doubt on its viability. We consider IMH from two perspectives: a method to determine the proportional loss allocation to each clearing participant and secondly where initial margin (IM) is considered specifically as a resource for loss allocation.

We also consider IMH in relation to VMGH, and while we accept that IMH would more widely distribute the loss, we are concerned that IMH does not comprehensively achieve intended objectives and could introduce adverse risk incentives. VMGH, relative to IMH, maintains three key advantages: (1) it incentivises clearing participants to engage in behaviors that improve the availability of risk-reducing hedges to the CCP whereas IMH could promote behaviors that do not, (2) VMGH mirrors existing economics of what would happen if a CCP were to exhaust its waterfall, and (3) IMH could effectively instigate counter-productive market activity during a default management process as discussed in the following paragraph.

As suggested within paragraph 3.5.20 of the consultative report, there is doubt as to the ability to determine the amount of any IMH, further exacerbated by the potential immediate and unpredictable requirement for CMs to replenish IM requirements (paragraph 3.5.23), which may challenge *Accounting Criteria* to net cleared derivative exposures for financial reporting and regulatory capital purposes. We agree that "... participants, in particular indirect participants, may be unable or unwilling to participate in a CCP if their initial margin is subject to loss for reasons other than their own default" (paragraph 3.5.24). Further, any practice that could weaken the determination of IM as bankruptcy remote (as contemplated in paragraph 3.5.23) is inconsistent with the regulatory capital framework for bank exposures to CCPs and could create additional capital charges for clearing participants.⁸

Further, we believe IM is posted solely to support the performance of the non-defaulting clearing participants, and is specifically not intended for any risk mutualisation purposes. Consequently, we oppose any proposal in which a non-defaulting clearing participant's IM could be used as a loss recovery tool in any circumstance.

Consideration of moral hazard implications

We believe that it is critical CPSS-IOSCO carefully consider the moral hazard implications of the recovery measures it endorses. It would appear the consensus view that traditional bankruptcy liquidation proceedings are wholly ill-suited for CCPs (since they would fail to ensure uninterrupted continuity of systemically important clearing services) is driving the pursuit of making CCPs altogether bankruptcy-proof through the implementation of recovery measures. In pursuing this goal, CPSS-IOSCO should bear in mind that to the extent that recovery measures insulate the board and senior management of a CCP (or its holding company) from the consequences of inappropriate risk-taking, a resulting unintended consequence could be an increase in moral hazard risk. In seeking to avoid the failure of CCPs, CPSS-IOSCO could be unintentionally creating a new, and much more potent, version of too-big-to fail.

We encourage CPSS-IOSCO, in analyzing the appropriateness of any recovery measure, to actively consider mitigants to moral hazard risk. For example, CPSS-IOSCO could consider a requirement that in any case in which a clearing participant suffers losses as a result of a CCP's utilization of a recovery measure, the CCP (or its holding company) should issue the affected clearing participant a senior convertible debt note with a principal amount equal to the clearing participant's losses. The terms of the note would provide for amortization of the note with the CCP's net profits before they are divided up to its holding company and out to shareholders and, subject to applicable regulatory constraints,

⁸ Basel Committee on Banking Supervision Consultative Document: Capital treatment of bank exposures to central counterparties (BCBS253)

would allow the clearing participant to convert the note into equity of the CCP or its holding company so that the clearing participant would have the ability to influence the selection of board members. The amortization feature, in particular, could serve as a useful moral hazard mitigant since the potential for disruption of the distribution of net profits to shareholders could encourage shareholders to take an active interest in ensuring prudent risk management by the CCP's senior management.

IV. Analysis of tools to address uncovered liquidity shortfalls

Pre-arranged and highly reliable bilateral or syndicated liquidity arrangements with third-party institutions or CM bank affiliates could be a source of liquidity for CCPs to rely upon for purposes of uncovered liquidity shortfalls. However we also acknowledge the potential constraints (e.g. banks' leverage ratio, liquidity coverage ratio, single counterparty credit limits, wrong-way risk) and potentially significant costs for CCPs to obtain sufficient liquidity for shortfalls beyond Cover 1 / Cover 2, in particular for less liquid forms of IM collateral (e.g. corporate bonds). We have suggested that IM collateral consist primarily of collateral in which a systemically important CCP could post to a central bank. In cases where a CCP does not have direct access to central bank facilities, we consider that indirect liquidity access through CMs via "... a collateralized loan, a repo or a swap transaction" (paragraph 3.63) be supported including the ability to post any received collateral to the CMs receiving central bank.

We believe that CCPs should adopt arrangements, agreed with CMs on an ex ante basis, for allocating uncovered liquidity requirements pro-rata across CMs therefore ensuring that the process is predictable and equitable. All such arrangements should be by way of collateralized loan or repo transaction, subject to an appropriate haircut that is not at the discretion of the CCP, such that the CM has the ability to onward pledge the securities to the central bank and obtain liquidity. However, in drafting such rules, CCPs should be cognizant of the challenges faced by non-bank CMs providing liquidity (e.g. they may not have direct access to a central bank and/or may face regulatory constraints in obtaining liquidity from banking affiliates) and should ensure that the burden of obtaining liquidity in a crisis is not transferred from CCPs to their underlying CMs.

V. Analysis of tools to replenish financial resources

We support the utilization of assessment powers as suggested within the consultative report. As described in Section II of this response, assessment powers that are predefined, limited and quantifiable can be an effective mechanism and as such, in many cases, are already member to a CCP default management process.

VI. Analysis of tools to allocate losses not related to participant default

It is difficult to anticipate the size and nature of losses not related to clearing participant default (i.e. non-default losses, or "NDL", paragraph 3.8.1) and further to which entities such losses should be allocated. As NDLs are losses that exceed a CCP's financial resources above the minimum regulatory capital requirements, and are not the result of any CM default (paragraph 3.8.1), any resulting liability should not be borne by clearing participants.

We consider that regulatory standards should be explicit that the losses resulting from NDL should accrue firstly through the CCP ownership and control structure. That is, NDL should be borne first by the holders of the CCP's equity and debt, and thus should only impact a clearing participant to the extent that the clearing participant has an equity or debt claim on the CCP's capital. We consider that any NDL exceeding the CCP's capital should be covered by a bail-in regime. The bail-in regime may be supplemented by insurance contracts that cover a limited quantum of losses in excess of a CCP's minimum regulatory capital requirements. However, an appropriate bail-in or insurance regime would take time to develop, agree and implement. Debt securities are common bail-in instruments for banks but are not commonly issued by CCPs. In the absence of bail-in, other statutory resolution such as business transfers to bridge institutions might be considered.

VII. Tools for CCPs to re-establish a matched book

If we are not to challenge requisite *Accounting Criteria* to net cleared transactions for financial reporting and regulatory capital purposes, certain tools to re-establish a matched book are not acceptable. Therefore, we caution against the utilization of position-based allocation tools like mandatory selective/partial tear-up or forced allocations and call attention to potential conflict with the *Key Principles* as well as negative effects on clearing participants' confidence in the FMI (paragraph 3.5.12).

Accounting guidance is particularly sensitive to position-based loss allocation tools, such as selective/partial tear-up and forced allocation which challenge the ability to demonstrate requisite *Accounting Criteria*, to net cleared derivative exposures for financial statement and regulatory capital purposes. We believe the inability to net, thus report all cleared derivative exposures gross for financial statement and regulatory capital purposes would render clearing uneconomical. Additionally, the ability to net cleared derivative exposures is particularly challenged in scenarios where position-based loss allocation tools are part of the general default management process or do not explicitly provide for *pro-rata allocation for all clearing participants*. In such scenarios, more specifically, the determination of a CCP as a principal party (i.e. acting as principal, not agent), the ability to assert "determinable amounts" is difficult, by definition, to achieve.

Therefore a CCP should depend on mechanisms such as predefined, limited and quantifiable assessment rights and VMGH and further that it maintain sufficient funds to rely on such mechanisms. Where a CCP and its CMs determine that the default management process, including rebalancing through auction and any voluntary mechanisms, fails to manage or reduce the risk, the CCP rulebook should prescribe full tear-up of contracts within the segregated clearing service. The rulebook should not, for reasons described within, contain any forced allocation, invoicing back, partial non-voluntary tear-up, or any other actions that threaten the ability of banks to hold cleared derivatives on a net basis.

VIII. Conclusion

We would welcome the opportunity to discuss any of these comments in further detail including components of the ISDA technical paper to ensure that we are engaged appropriately with the process of developing the recovery, continuity and resolution framework.

Yours Sincerely,



Ryan Ingram
Risk and Capital
ISDA



Alex Radetsky
Associate General Counsel
TCH



David Schraa
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Appendix – Description of the Associations

International Swaps and Derivatives Association (ISDA)

Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 60 countries. These members include a broad range of OTC 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 including exchanges, clearinghouses 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 web site: www.isda.org.

Institute of International Finance, Inc. (IIF)

The IIF is a global association created in 1983 in response to the international debt crisis. The IIF has evolved to meet the changing needs of the international financial community. The IIF's purpose is to support the financial industry in prudently managing risks, including sovereign risk; in disseminating sound practices and standards; and in advocating regulatory, financial, and economic policies in the broad interest of members and foster global financial stability. Members include the world's largest commercial banks and investment banks, as well as a growing number of insurance companies and investment management firms. Among the IIF's Associate members are multinational corporations, consultancies and law firms, trading companies, export credit agencies, and multilateral agencies. All of the major markets are represented and participation from the leading financial institutions in emerging market countries is also increasing steadily. Today the IIF has more than 450 members headquartered in more than 70 countries. For more information, please visit www.iif.com.

The Clearing House (TCH)

Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world's largest commercial banks, which collectively employ over 2 million people and hold more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing—through regulatory comment letters, amicus briefs and white papers—the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost \$2 trillion daily and representing nearly half of the automated-clearing-house, funds-transfer, and check-image payments made in the U.S. See The Clearing House's web page at www.theclearinghouse.org.