DCO Stress Testing and Liquidity
Areas for Discussion

Report of the
Central Counterparty Risk and Governance Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission

Acting Chairman Rostin Behnam, Sponsor

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MRAC Subcommittee on CCP Risk and Governance
Workstream on Stress Testing and Liquidity

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Representatives on the MRAC Subcommittee on CCP Risk & Governance (the "**Subcommittee**") from derivatives clearing organizations ("**DCOs**"), clearing members, and end-users (the latter two collectively referred to as "**market participants**") held multiple meetings to discuss their perspectives on CCP Stress Testing and Liquidity. This paper reflects the collective work of the Subcommittee in those meetings, including areas of consideration for the CFTC related to central counterparty ("CCP") stress testing and liquidity. It also identifies topics on which the members of the Subcommittee could not reach agreement. Consequently, it does not make specific recommendations to the MRAC.

There was broad agreement in the Subcommittee that stress testing of DCOs is a critical element to ensuring the resilience of DCOs and the financial system. As such, many of the practices for stress testing by DCOs identified by the Subcommittee are practices that are employed by many DCOs today, particularly by the systemically important DCOs ("**SIDCOs**") and those electing to be subpart C DCOs. These broad areas of agreement reflect the *Principles for Financial Market Infrastructures* ("**PFMI**") and are set out in the box below. Despite these areas of agreement, there remain areas in which the DCOs and market participants disagree.

Highlights of the areas of discussion can be summarized as follows:

- Credit Stress Testing: It was broadly agreed that it is appropriate for most, if not all, DCOs to employ stress tests that are designed to calibrate its financial resources to withstand the default of its two largest clearing members (i.e., Cover 2 standard), which is already required of SIDCOs and electing subpart C DCOs. Therefore, the CFTC should consider whether the Cover 2 standard should apply to all DCOs.
- Stress Scenarios: Stress testing should be aimed at identifying tail risks for the CCPs that could be exposed by shocks in stress periods. A number of considerations/risks like liquidity, concentration and correlations were identified in sizing financial resources for stress tests, if those considerations/risks are not sufficiently captured by initial margin. Furthermore, a relevant look-back period in such tests should be 30 years or the longest period available reliable and relevant data history.
- Reverse Stress Testing: A DCO should consider analyzing its stressed loss distribution by member (and its credit risk) with reverse stress tests ("**RST**").
- Stress Period of Risk ("**SPOR**"): SPOR should be at least equal to the margin period of risk ("**MPOR**") that is assumed when calculating the relevant initial margin levels. As discussed below, the stressed period of risk could in some instances be longer than the MPOR, reflecting the stress-related increase in volatility and reduction in market liquidity.
- Default Fund Re-Sizing: Its preferable for a DCO to regularly re-size its default fund resources on a monthly, rather than on a quarterly, basis.
- Liquidity Stress Testing: there was broad agreement that liquidity risk management at DCOs is critical for both DCOs and the financial system and in considering liquidity risk

management the following actions should be considered: to strive for global best practices; to promote a further global discussion on liquidity stress testing; and, to promote global consistency across borders on what is considered liquid collateral.

- Access to central bank accounts. It was agreed that CCP access to central bank accounts with appropriate oversight and governance should be broadened across jurisdictions.
- Transparency: The sub-committee discussed the merits of DCOs providing greater transparency on matters relating to stress testing, with no agreement being established.

Credit and Liquidity Stress Tests conducted by CCPs

Stress tests conducted by CCPs should be used to calibrate resources needed for resilience of the CCP to withstand extreme but plausible market shocks sufficient to result in the default of its largest clearing member(s). CCP's are subject to PFMIs as outlined below.

Summary PFMI Stress Testing and Liquidity Requirements

The existing PFMI for CCPs set out standards in these areas. Principles 4 through 7 of the PFMI spell out the core of the standards for financial risk management and financial resources at CCPs. They cover credit risk management (i.e., Principle 4), collateral (i.e., Principle 5), margin (i.e., Principle 6), and liquidity risk management (i.e., Principle 7). As the PFMI note, "these principles contain extensive cross references because of the interaction among the four standards. For example, the margin principle builds on the credit risk principle as applied to CCPs." [1] The Subcommittee took account of those interactions in discussing the issues.

PFMI Principle 4 spells out two key considerations for credit stress testing. Key Consideration 5 requires that: "A CCP should determine the amount and regularly test the sufficiency of its total financial resources available in the event of a default or multiple defaults *in extreme but plausible market conditions* through rigorous stress testing (italics added)."[1] Key Consideration 6 requires that: "In conducting stress testing, a CCP should consider the effect of a wide range of relevant stress scenarios in terms of both defaulters' positions and possible price changes in liquidation periods."[2]

[1] PFMI, p 36

[2] In addition, it specifies that: "Stress tests should be performed daily using standard and predetermined parameters and assumptions. On at least a monthly basis, a CCP should perform a comprehensive and thorough analysis of stress testing scenarios, models, and underlying parameters and assumptions used to ensure they are appropriate for determining the CCP's required level of default protection in light of current and evolving market conditions. A CCP should perform this analysis of stress testing more frequently when the products cleared or markets served display high volatility, become less liquid, or when the size or concentration of positions held by a CCP's participants increases significantly. A full validation of a CCP's risk-management model should be performed at least annually."*See* https://www.bis.org/cpmi/publ/d101a.pdf

Generally, PFMI requirements have been implemented across the globe by local regulators, including the CFTC.[3] In particular, the CFTC implemented the practices included in the PFMI in Part 39 of its regulations – specific CFTC regulations relevant to this paper are highlighted below.

In addition to setting standards for CCP stress testing, CPMI-IOSCO published the *Framework for supervisory stress testing of central counterparties* in April 2018. Notwithstanding the importance of supervisory stress testing and the benefit of a broader view of stress testing across DCOs, the paper does not consider supervisory stress testing frameworks.

Finally, the paper includes an appendix that specifies CFTC regulations related to CCP stress testing and liquidity.

1. Credit Stress Tests

In line with the key considerations noted in the box above, all DCOs must comply with CFTC Regulations 39.11(a)(1) and (c)(1)-(2), which establish requirements for the size and calculation of a DCO's financial resources for managing defaults, including stress testing. Additionally, SIDCOs and electing subpart C DCOs must comply with CFTC Regulations 39.33(a)(1) and 39.36(a)(1)-(6), which establish additional requirements related to these DCOs' financial resources.

1.1. Size of Financial Resources for Default

Consistent with the PFMI and CFTC Regulation 39.11(a)(1), a DCO's stress tests must be designed to calibrate the resources needed for resilience of DCO to withstand extreme but plausible market shocks that result in the default of at a minimum the single largest clearing member (and its affiliated clearing members) (i.e., Cover 1 standard). However, it is appropriate for most, if not all, DCOs to employ stress tests that are designed to calibrate its financial resources to withstand the default of its two largest clearing members (and their affiliated clearing members) under extreme but plausible market conditions (i.e., Cover 2 standard), which is already required of SIDCOs and electing subpart C DCOs pursuant to CFTC Regulation 39.33(a)(1). Therefore, the CFTC should consider whether the Cover 2 standard should apply to all DCOs. Each individual CCP should also consider whether a Cover 2 standard is appropriate to account for the unique risk distribution of its particular membership.[4]

Further suggestions for consideration include:

- In line with CFTC Regulations 39.11(c)(1) and 39.33(a)(1), it is prudent to assume that defaults would either occur concurrently or in short succession, using extreme but plausible historical, hypothetical (i.e., what-if scenarios) and theoretical (i.e., statistical scenarios) simulations.
- The CCP should also consider analyzing its stressed loss distribution by member (and its credit risk) with RST.

[3] In addition, it specifies that: "Scenarios should include relevant peak historic price volatilities, shifts in other market factors such as price determinants and yield curves, multiple defaults over various time horizons, simultaneous pressures in funding and asset markets, and a spectrum of forward-looking stress scenarios in a variety of extreme but plausible market conditions." *See* https://www.iosco.org/library/pubdocs/pdf/IOSCOPD599.pdf

[4] While EMIR requires Cover 2 and SIDCOs and DCOs that opt into subpart C DCO rules in the U.S. size financial resources to meet this Cover 2 standard, several jurisdictions (in APAC, LATAM and Canada) do not require the Cover 2 standard.

- In line with CFTC Regulations 39.11(a)(1) and 39.33(a)(1), entire groups (i.e. including affiliate members) should be considered in stress testing. The framework should reflect additional risks to the CCP arising from the simultaneous failure of entities in the group of the defaulting clearing member.

1.2. Stress Scenarios

Stress scenarios must be appropriately designed by a DCO to size its financial resources to adequately account for close-out costs under extreme but plausible market conditions. These scenarios should be tailored to the particular set of products cleared by the DCO and should include both historical and hypothetical stress scenarios. Stress scenarios typically draw on historical experience – what has happened - as well on hypotheticals-what could happen. In practice, the stress envisioned in hypothetical scenarios is in most instances more severe than in historical experience and thus the hypothetical scenarios should generally be applied as the yardstick to assess the adequacy of the CCP's resources to address defaults.

In designing stress test scenarios, CCPs should be required to specify and disclose the ways in which they address considerations such as the look-back period and historical events, the maximum change to equity indices, interest rate, various commodity markets, volatility, most relevant correlations, and which scenario is driving the maximum stress loss. These drivers are either reflected in initial margin (i.e., defaulter pays) or the default fund sizing (i.e., mutualization) and it is important that DCOs maintain discretion to determine the appropriate balance between having the defaulter pay and mutualization, since this balance has an impact on participants' incentives to effectively manage their risk-taking.

Further suggestions for consideration include:

- Look-back period: A DCO shall determine the appropriate historical time period based on the characteristics, including volatility patterns, as applicable, of the products and portfolios cleared. This can include a relevant look-back history, taking into account stress periods that should be used in devising historical scenarios and defining the risk appetite. The Subcommittee agreed that a relevant look-back period would be 30 years or the period with the longest available **reliable** and **relevant** data history; this is in line with best practices of many DCOs. Adjustments for changes in market structure may also be incorporated in a DCO's stress testing methodology.

- Consideration for market-wide drop in liquidity: Scenarios should take into account the interaction between market liquidity and member default, as the CCP's ability to close out positions upon a member default may be compromised. An increase in liquidation costs due to a widened bid-offer spread may be experienced. Liquidity add-ons can either be reflected in initial margin or in the default fund resources. A CCP should consider when calibrating default fund sizes via stress testing if such liquidity costs may increase beyond what is covered by initial margin. The liquidity stress assumed in stress testing should at least match the assumption used in calibrating initial margin.

- Concentration: Concentrated positions can drive losses in a default scenario and should be looked at in conjunction with the respective liquidity in the relevant product. These risks should either be reflected in initial margin or in the default fund resources.

- Directly Address Correlations: Given the offsets that CCPs allow across products, CCPs should be careful to consider stressed correlations or de-correlation scenarios. These should either be reflected in initial margin or in default fund resources.

- Comprehensive: CCP risk frameworks should reflect all risks that could impact the loss incurred by the CCP in managing a member default including, for example, wrong-way risk in CDS/equity products. These should either be reflected in initial margin or in default fund resources.

- Collateral Valuation: In accordance with CFTC Regulation 39.13(g)(12), collateral valuation should be subject to haircuts calibrated using extreme but plausible market scenarios. Some market participants believe such haircuts should be reviewed, ideally, daily rather than the currently stipulated monthly.

- Assume a Dynamic Feedback Loop: In the future, scenarios should include an analysis of the feedback loop where a clearing member default in itself triggers a stress event, or an amplification of the diverse stress events defined above, and also include an appropriate framework responsive to market changes/ conditions as well as CCP exposures to members. CCPs should take into account the interaction between member defaults and market reaction in generating hypothetical stress scenarios. Particularly for CCPs with concentrated membership, a default of a large member may result in significant market dislocations that will exceed any stresses observed historically. Likewise, the membership in large CCPs is significantly overlapping, so the default of a large clearing member will almost certainly spill over into several CCPs. This potential future development requires a stronger disclosure framework for market participants than is currently in place.

1.3. Stress Period of Risk assumption

SPOR and MPOR should always be seen in conjunction with one another and the SPOR cannot be smaller than the MPOR.

Indeed, the stressed period of risk could in some instances be longer than the MPOR as one approach to reflect reduced market liquidity in times of stress. Stressed markets are characterized not only by increased volatility but likely also by reduced market liquidity, which would increase the time required to liquidate defaulted portfolios. Equally, stressed markets could impact the cost of liquidating a portfolio which is something CCPs can reflect by stressing liquidity or concentration add-ons. There is a known duality of either warehousing positions longer and thus facing market risk longer but having lower bid-ask spreads or pushing to liquidate positions faster but accepting wider bid-ask spreads. A CCP's default management strategy typically involves entering into hedges. CCPs employing this strategy should demonstrate consideration for illiquid markets when estimating the stressed period of risk, as well as the risk related to hedging counterparties.

1.4. Re-sizing

Subcommittee members agree that a monthly re-sizing of the default fund is preferable to a quarterly one and that allocation of default funds (i.e., determination of clearing members contributions) should be risk-based. By way of example, this could mean the default fund's allocation takes into account uncollateralized stress losses, but may also include other factors deemed appropriate by the DCO (e.g., initial margin, volumes, and/or open interest) in order to keep incentive mechanism strong and in place.

Where an intra-month re-sizing of the default fund is required based on daily stress testing, a DCO should address the situation based on the prevailing facts and circumstances. This may call for re-sizing the default fund or calling for additional margin from specific clearing members. For example, where it appears that the stress testing losses of a DCO's clearing members are increasing across the board, it may be appropriate for the DCO to re-size its total mutualized resources. Notwithstanding

this, DCOs typically employ practices (e.g., buffers) that are designed to mitigate the need to re-size the mutualizable resources on an ad hoc basis.

2. Liquidity Risk and Stress Tests

Principle 7 of the PFMIs covers liquidity risk. Simply put it states: "An FMI should effectively measure, monitor, and manage its liquidity risk." [5] Key Consideration 1 specifies that: "An FMI should have a robust framework to manage its liquidity risks from its participants, settlement banks, nostro agents, custodian banks, liquidity providers, and other entities. Key Consideration 9 states that: "An FMI should determine the amount and regularly test the sufficiency of its liquid resources through rigorous stress testing."[6] In line with these key considerations, all DCOs must comply with CFTC Regulation 39.11(e)(1), which establishes requirements for the size and calculation of a DCO's liquidity resources. Additionally, SIDCOs and electing subpart C DCOs must comply with CFTC Regulations 39.33(c)-(d) and 39.36(c)(1)-(7), which establish additional requirements related to these DCOs' liquidity resources.

Suggestions for consideration include:

- Market participants believe that liquidity stress testing scenarios and coverage models should be consistent with credit stress testing (and as noted above in Section 1.2, their interaction should be included in the tests). Effectively, stating that where a CCP is subject to cover-2 credit standard, it should be subject to cover-2 liquidity standard taking into account the local jurisdiction's definition and treatment of what constitutes liquid resources.

- However, most DCOs of the Subcommittee believe that while SIDCOs and electing subpart C DCOs adhere to a Cover 2 standard for financial resources it does not necessarily mean that it should also adhere to a Cover 2 liquidity standard, since the types of assets available to meet these standards vastly differ. In particular, under CFTC Regulation 39.33(c)(3), SIDCOs and electing subpart C DCOs can only satisfy the Cover 1 liquidity standard with "qualifying liquidity resources", which requires that highly marketable collateral only be treated as qualifying liquidity resources where they are supported by prearranged and highly reliable funding arrangements. Thus, SIDCOs and electing subpart C DCOs cannot treat high-quality sovereign debt, including U.S. Treasury securities, as qualifying liquidity resources *prima facie*, whereas U.S. Treasury securities can be used to satisfy these DCOs' financial resources requirements. There is also a difference beyond the type of collateral, which is the amount

[5] Principle 7 adds, "An FMI should maintain sufficient liquid resources in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate liquidity obligation for the FMI in extreme but plausible market conditions."

[6] In addition, KC 9 specifies: "An FMI should have clear procedures to report the results of its stress tests to appropriate decision makers at the FMI and to use these results to evaluate the adequacy of and adjust its liquidity risk-management framework. In conducting stress testing, an FMI should consider a wide range of relevant scenarios. Scenarios should include relevant peak historic price volatilities, shifts in other market factors such as price determinants and yield curves, multiple defaults over various time horizons, *simultaneous pressures in funding and asset markets*, and a spectrum of forward-looking stress scenarios in a variety of extreme but plausible market conditions. Scenarios should also take into account the design and operation of the FMI, include all entities that might pose material liquidity risks to the FMI (such as settlement banks, nostro agents, custodian banks, liquidity providers, and linked FMIs), *and where appropriate, cover a multiday period*. In all cases, an FMI should document its supporting rationale for, and should have appropriate governance arrangements relating to, the amount and form of total liquid resources it maintains." Italics added.

of total collateral that can be counted for each clearing member under different regulatory regimes.

- In addition, access to central bank accounts should be broadened across jurisdictions. CCPs typically invest cash collateral to mitigate settlement bank risk; however, this has the consequence of impacting the available liquidity as CCPs would need to liquidate these investments to obtain cash. We would therefore suggest considering making all CCPs eligible for deposit accounts at the central bank, subject to appropriate regulatory oversight and supervision, so that they can securely hold cash without being forced to invest cash. This would ease liquidity requirements of CCPs in stressed market conditions.

Appendix

U.S. Regulation

The following *CFTC Part 39 "Derivatives Clearing Organizations"* cover the requirements on credit and liquidity stress testing applicable to DCOs.
https://www.ecfr.gov/cgi-bin/text-idx?SID=79452713d116ca7e248dfb358011c202&mc=true&node=pt17.1.39&rgn=div5

Subpart B—Compliance with Core Principles (applicable to Eurex Clearing)

- **§39.11 (c) Financial resources – on Liquidity Risks**
  - *"(c) Calculation of financial resources requirements. (1) A derivatives clearing organization shall, on a monthly basis, perform stress tests that will allow it to make a reasonable calculation of the financial resources needed to meet the requirements of paragraph (a)(1) of this section."*
- **§39.13 (h) Risk management – on Stress Tests**
  - *"(3) **Stress tests**. A derivatives clearing organization shall conduct stress tests, as defined in §39.2 of this part, as follows (i) On a daily basis, a derivatives clearing organization shall conduct stress tests with respect to each large trader who poses significant risk to a clearing member or the derivatives clearing organization (ii) On at least a weekly basis, a derivatives clearing organization shall conduct stress tests with respect to each clearing member account, by house origin and by each customer origin, and each swap portfolio"*

Subpart C—Provisions Applicable to Systemically Important Derivatives Clearing Organizations (applicable to e.g., LCH, ICE, CME, OCC, MGX, ICE Clear US)

- **§39.36 Financial resources**
  - ***(a) Stress tests of financial resources**. In addition to conducting stress tests pursuant to §39.13(h)(3), each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall conduct stress tests of its financial resources in accordance with the following standards and practices:*
    (1) Perform, on a daily basis, stress testing of its financial resources using predetermined parameters and assumptions;
    (2) Perform comprehensive analyses of stress testing scenarios and underlying parameters to ascertain their appropriateness for determining the systemically important derivatives clearing organizations or subpart C derivatives clearing organization's required level of financial resources in current and evolving market conditions;
    (3) Perform the analyses required by paragraph (a)(2) of this section at least monthly and when products cleared or markets served display high volatility or become less liquid, when the size or concentration of positions held by clearing members increases significantly, or as otherwise appropriate, evaluate the stress testing scenarios, models, and underlying parameters more frequently than once a month;
  - ***(c) Stress tests of liquidity resources**. Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall conduct stress tests of its liquidity resources in accordance with the following standards and practices:*
    (1) Perform, on a daily basis, stress testing of its liquidity resources using predetermined parameters and assumptions;
    (2) Perform comprehensive analyses of stress testing scenarios and underlying parameters to ascertain their appropriateness for determining the systemically important derivatives clearing organizations or subpart C derivatives clearing

organization's required level of liquidity resources in current and evolving market conditions;
(3) Perform the analyses required by paragraph c (2) of this section at least monthly and when products cleared or markets served display high volatility or become less liquid, when the size or concentration of positions held by clearing members increases significantly, or as otherwise appropriate, evaluate its stress testing scenarios, models, and underlying parameters more frequently than once a month

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SUPPORTING STATEMENTS

BlackRock

July 1, 2021

BlackRock Statement in support of CFTC MRAC CCP Risk and Governance Subcommittee Papers

BlackRock commends Acting Chair Behnam for establishing the CFTC's CCP Risk & Governance Subcommittee to provide reports and recommendations regarding issues impacting clearinghouse risk management and governance. BlackRock believes that stable and secure financial markets are paramount to the protection of end-users' investment activity and is pleased to have had the opportunity to engage in constructive dialog with industry participants to advance market integrity and financial stability.

Over the course of the last 18 months, Subcommittee members representing Central Counterparties (CCPs), clearing members and end-users (the latter two collectively referred to as "market participants") have worked to find agreement on CCP risk issues that have previously been identified by market participants as areas of concern. The CFTC provided a unique forum in which stakeholders in cleared markets could come together to debate often controversial and divisive topics.[1] At the February 23, 2021 MRAC meeting, the Subcommittee presented papers on CCP Margin Methodologies and CCP Governance; at the July 13, 2021 MRAC meeting, two additional papers are being presented: CCP Liquidity and Stress Testing, and CCP Capital and Skin in the Game. While the Subcommittee members spent a meaningful amount of time discussing CCP Transparency, members were unable to reach any areas of agreement.

The Subcommittee papers represent an important part of a broader endeavor to enhance financial stability that is supported by CCPs, clearing members and end-users alike. BlackRock therefore encourages the CFTC and other relevant regulatory authorities to: (1) pursue rulemaking to implement recommendations put forth in the papers, (2) explore whether additional regulation could further buttress areas of agreement put forth in the papers, (3) consider regulatory intervention where the papers put forth specific areas of disagreement, and (4) conduct further diligence on the members' perspectives on CCP Transparency, where no paper could be put forth.

[1] Many of the discussion topics mirrored recommendations in A Path Forward for CCP Resilience, Recovery, and Resolution, a paper that BlackRock co-authored with a group of a buy-side and sell-side firms, released in 2019. The paper proposed twenty recommendations to enhance CCPs' resilience, recovery and resolution.

CME Group

July 1, 2021

CME Group Statement on CFTC MRAC CCP Risk and Governance Subcommittee Papers

CME Group Inc. ("CME Group")[1] commends Acting Chairman Behnam for establishing the Market Risk Advisory Committee's ("MRAC") CCP Risk and Governance Subcommittee ("Subcommittee"). The Subcommittee provides a useful and effective forum for discussing areas of interest and providing recommendations to the broader MRAC with a focus on the stability of the broader financial system.

We applaud members of the Subcommittee, which includes representatives from across the industry, for successfully working together to recognize the importance of the risk management practices utilized by derivatives clearing organizations ("DCOs") and preserving the incentives endemic to the central clearing model that promote effective risk management. Most recently, the Subcommittee successfully worked together to publish papers on CCP capital and skin-in-the-game and stress testing and liquidity risk management. While these are topics that have been discussed amongst the industry for a number of years, the Subcommittee reached agreement in a number of areas, reflecting a consensus from the Subcommittee of the importance of best practices in risk management.

The areas of agreement reached by the Subcommittee in regard to CCP capital, stress testing and liquidity risk management allow DCOs to continue to follow their regulatory mandate to prioritize the safety of their markets and stability of the broader financial system, while preserving the incentives that are critical to ensuring that risk-takers effectively manage their risks. We are pleased with the cohesion demonstrated by the Subcommittee in agreeing on unbiased risk management best practices rather than focusing on policy proposals that skew incentives and negatively impact the ability of DCOs to manage risks and continue to successfully navigate market stress events in the future. We look forward to ongoing engagement on how to further solidify the robust risk management practices utilized by DCOs to enhance financial stability and reduce systemic risk.

[1] Chicago Mercantile Exchange Inc. is a registered derivatives clearing organization.

JPMORGAN CHASE & CO.

July 1, 2021

JPMorgan Statement on CFTC MRAC CCP Risk and Governance Subcommittee Reports

JPMorgan commends Acting Chair Behnam for establishing the CFTC's CCP Risk & Governance Subcommittee (Subcommittee) and supporting the development of actionable recommendations on these topics. The topics discussed within the Subcommittee covered many of issues highlighted within A Path Forward for CCP Resilience, Recovery, and Resolution, a white paper that JPMorgan, together with a group of a buy-side and sell-side firms, released in 2019 (2019 White Paper).[1] The 2019 White Paper proposes twenty recommendations to enhance CCPs' resilience, recovery, and resolution, for consideration by policymakers and regulators.

Over the last eighteen months, JPMorgan has supported and contributed to the efforts of the Subcommittee, seeking to make progress on the important topics of CCP risk governance, CCP margin, CCP transparency, CCP capital and skin-in-the-game, and CCP stress testing and liquidity. While the Subcommittee presented agreed-upon recommendations to the MRAC and CFTC on CCP margin and CCP risk governance in February, all of which JP Morgan supported, we note that the Subcommittee was unable to agree specific actionable recommendations for the CFTC within the June reports on CCP Capital and Skin-in-the-Game or Liquidity and Stress Testing. Both reports provide summaries of what was discussed, noting where policy views are aligned between market participants and CCPs and specify where no agreement was reached. While we support the two June reports, on CCP Capital and Skin-in-the-Game specifically, we also reiterate the views expressed in the 2019 White Paper: increasing CCP contributions to the default waterfall to a meaningful quantum of CCP SITG; requiring CCPs to be responsible for non-default losses, supported by appropriately-sized regulatory capital requirements; residual CCP capital being available as a last resort to absorb outstanding losses; and requiring CCPs to set aside recapitalization resources (e.g., long-term debt that could be bailed in).

Importantly, despite a significant amount of work performed by the CCP transparency and disclosure work-stream and extensive discussion on this topic among Subcommittee members, the Subcommittee was unable to agree upon a report to be presented to the MRAC and CFTC. Similarly, as noted within the Liquidity and Stress Testing report, the Subcommittee discussed the merits of CCPs providing greater transparency on matters relating to stress testing, with no agreement being established. The Subcommittee's inability to advance recommendations on this topic, as well as on CCP capital and skin-in-the-game, underscores the need for policymakers to consider these topics alongside CCP risk governance and margin and determine whether regulatory intervention is required in the best interests of the market as a whole. Work on addressing the issues raised in the 2019 White Paper is critical and we stand ready to partner with regulators, policymakers, CCPs, and other market participants to further enhance CCP risk and governance and strengthen the US financial system.

[1] The paper was originally published in October 2019 and now has twenty signatories.