



2nd Floor  
36-38 Botolph Lane  
London EC3R 8DE.

FIA-europe.org  
T +44 (0)20 7929 0081  
F +44 (0)20 7621 0223

7 May, 2015

**CME Clearing Europe ('CME')**  
**Lee Betsill, CEO**

**ICE Clear Europe ('ICE')**  
**Paul Swann, CEO**

**LCH.Clearent Limited ('LCH')**  
**Martin Pluves, CEO**

**LME Clear**  
**Trevor Spanner, CEO**

Dear all

Clearing members believe that any loss incurred by a CCP as a result of anything other than a default of a clearing member should be borne by the CCP's own capital and/or appropriate insurance coverage. Clearing members should only be expected to contribute towards losses caused by a clearing member default. They appreciate that U.K. CCPs are required, from 1 May 2014, to have rules in place that address the allocation of non-default losses that threaten the CCP's solvency and to have plans to maintain continuity of services if such continuity is threatened as a result of such losses.

Our primary aim in sending this letter is to achieve greater certainty and transparency around the rules in place relating to the calculation and distribution of non-default losses. Set out below are a number of points that clearing members would like to see addressed by way of amendments to the existing rulebooks.

In support of this stance, we would draw attention to Article 43(3) of EMIR which states that "*The clearing members of a CCP shall have limited exposures toward the CCP*" as well as report from CPMI/IOSCO from October 2014 entitled "Recovery of financial market infrastructures", which states that: "*recovery tools should be transparent and allow those who would bear losses and liquidity shortfalls to measure, manage and control their potential exposure*" (<http://www.bis.org/cpmi/publ/d121.pdf>).

***Scope of relevant losses***

Clearing members would like to achieve consistency in respect of the scope of losses that can be claimed from clearing members. Currently the ICE rules limit "Investment Losses" to those caused by the default of an issuer or the counterparty to a repo/reverse repo transaction. They expressly exclude both custodial

losses and losses as a result of ICE's failure to follow its investment policies. Clearing members would like to align LCH, CME and LME Clear to this standard, especially in respect of the passing on of custodial losses.

### ***Calculation of loss allocations***

Currently, the rules of all three CCPs allocate losses on the basis of calculations considering total initial margin requirements (i.e. both clearing members' cash and non-cash collateral contributions). Clearing members believe this should be by reference to cash contributions alone. Those contributing non-cash only should not be impacted by the loss allocation mechanic as, according to the understanding of the FIA Europe members that contributed to this letter, non-cash assets are not invested by the CCPs but are held in custody. Only cash margin is at risk of investment loss.

Allocating the loss in line with the investment risk to the clearing house would also provide clearing members with an incentive to post more securities and therefore reduce the risk of an investment loss. Clearing members understand the CCP's concerns around liquidity in the event of switch to non-cash margin postings but believe that it is for the CCPs to have alternative means of ensuring that they have enough liquid resources.

### ***Caps on clearing member liability***

In order to limit the exposures of clearing members to investment losses, they would like to see caps introduced on the amounts that can be claimed from clearing members. Such caps on member liability should also cover the number of investment losses that could occur within a specified period. Any losses incurred above the amount of such cap would be covered from the CCPs own resources.

### ***CCP non-default loss-specific "skin in the game"***

Our members believe that there should be greater transparency around the first tranche of non-default loss-specific losses that the CCPs contribute. At present, ICE (\$90m) and LCH (€15m) both include a set figure whereas LME Clear's rules state that their contribution "shall not exceed the amount of regulatory capital maintained by LME Clear..." Our members would like all CCPs to include a clear figure in their rules, or accompanying instructions, as well as guidance on how such figure is initially calculated (by reference to their capital requirements) and amended (when those requirements change).

The CCP contribution should be dynamic and recalculated at regular intervals to reflect changes in the size and risk profile of the investment portfolios. There should also be a hard floor to the amount contributed as well as a clear obligation to replenish the amount if and when it is depleted. Finally, this contribution should be pre-funded and ring-fenced such that it can only be used to cover investment losses, thus incentivising the CCP to maintain an appropriate investment strategy. ICE's contribution can be depleted by any other loss that is not an investment loss nor caused by an event of default.

### ***Transparency***

Our members would like to see more transparency of information in respect of investment policies. Some transparency is given at a risk committee level but not currently to all clearing members. Such information should be sufficiently detailed and frequent such that all parties involved in a loss allocation are able, on

a monthly basis, to ascertain the makeup of the CCP's investment portfolio, any changes in CCP investment risk profile and each clearing member's potential share of any investment loss. Our members would also like to see more risk committee oversight of CCP investment decisions. This level of increased transparency is important to FIA Europe members for a number of reasons, including how clearing members determine the impact of investment losses on their capital calculations.

#### ***Alternatives to loss allocation***

In addition to the points raised above in respect of loss allocation, our members would like to explore further with UK CCPs whether alternative arrangements could be put in place. For example, insurance / credit default arrangements as an alternative to loss allocation, or by placing some / all cash initial margin on deposit with central banks thereby reducing / eliminating the risk of loss allocations created by the running of a reinvestment programme.

#### ***Loss recoveries***

In order to incentivize CCPs to pursue loss recoveries, any recovered losses should be distributed to clearing members impacted by the investment loss before the CCP itself. LME Clear have included such a provision in their rulebook but ICE and LCH's rules state that any recoveries will first go towards replenishing the CCP's losses and expenses. The rules of CME are silent on this point. Our members would also see an obligation including in the rulebook for the CCP to use "reasonable efforts" to pursue recoveries. Such a provision is included in the LME Clear rulebook but not in the rulebooks of ICE, CME or LCH.

#### ***Allocation to clients***

At present, investment losses are only able to be allocated amongst clearing members. In order to potentially facilitate the passing on of any such losses to clients, our members would like CCPs to commit to providing a breakdown of the amount of a clearing member's loss allocation such that the respective amounts for house and each type of client account are evident. In addition to this transparency of allocation, our members would also like the rulebooks to include provision for passing these identified losses to clients.

#### ***Conversions of clearing member contributions into equity***

Paragraph 3.4.7 of the CPMI/IOSCO report "Recovery of financial market infrastructures" (see link above) anticipates a mechanism by which clearing member payments to cover investment losses could be converted into equity at the CCP. Our members would be interested to know whether or not this is something that the CCPs are considering introducing.

#### ***Proposed further consultation periods***

When the CCPs first presented drafts of these rules, there were indications given that these were initial drafts published in order to meet the deadline set in legislation and that at some point in the near future, additional consultation would take place. We understand that one CCP has already begun this second round of consultation and we would be grateful if other CCPs could confirm whether or not they intend to enter into further rounds of industry consultation and in what timeframe they intend to do so.

We would be very happy to discuss the content of this letter further with you or your colleagues, should you deem that helpful. In case of any questions, please do not hesitate to contact Mitja Siraj ([msiraj@fia-europe.org](mailto:msiraj@fia-europe.org)) or me directly.

Kind regards

A handwritten signature in black ink, appearing to read 'S. Puleston Jones', with a horizontal line underneath.

Simon Puleston Jones  
Chief Executive Officer  
FIA Europe