



## **Response to the CPMI-IOSCO discussion paper on central counterparty default management auctions**

The FIA Principal Traders Group (“FIA PTG”) appreciates the opportunity to respond to the client participation questions in the discussion paper. FIA PTG is an association of firms that trade their own capital primarily in the exchange-traded and cleared derivatives markets. FIA PTG members are generally not clearing members. FIA PTG members engage in manual, automated and hybrid methods of trading, and are active in a wide variety of asset classes, including equities, fixed income, foreign exchange and commodities. FIA PTG members are a critical source of liquidity in the markets in which we trade, enabling those who use these markets, including commercial end-users, to manage their business risks and to enter and exit the markets efficiently.

21. For which markets, asset or product classes and client types would client participation be most feasible and/or desirable? What would be the incentives for clients to participate in auctions? Does this differ for direct vs indirect client participation? Please elaborate in your response.

Client participation should be welcomed across all asset classes and products. Having a diverse set of qualified participants will result in more competitive bids and increase the odds of having a successful default auction. Often, clients are the primary liquidity suppliers in a particular asset class or product group. It is critical to include principal traders and other liquidity providers in a default auction, as they often have the capacity to price and absorb a large risk transfer. Experience with client participation in CCP default auctions has demonstrated that clients bid aggressively, reducing the overall cost of resolving the default.

All default auction participants, including clients, should be vetted and approved by the CCP, as well as the participant’s applicable clearing member, in advance. Approval should include consideration of the following:

- Sufficient experience with the specific products to facilitate aggressive bidding and subsequent risk management should the participant be awarded the portfolio.
- Adequate operational expertise to facilitate analyzing the portfolio quickly and returning a competitive bid in the timeframe required during a default auction.
- Successful completion of CCP default management program (DMP) testing and drills.
- Execution of requisite CCP non-disclosure agreements.

FIA PTG does not believe there is any reason for clearing members other than the client’s clearing member to approve a client’s participation in a default auction.

We do believe that direct participation is the best method for bid submission in order to remove any potential conflicts of interest between the client and its clearing member, both of whom may be bidding in the auction. Once the client and its clearing member have agreed on the

client's participation in the default auction and other variables – initial margin limits etc., there is no reason for the clearing member to see the actual bid amount. During the bidding process it is critical that bid amounts remain as confidential as possible, accordingly they should not pass through the clearing member.

22. The discussion paper describes some ways to address the risks borne by a clearing member arising from its clients bidding in an auction. Are there additional ways to address the risks? Are there incentives that a CCP could employ to encourage client participation in an auction (e.g. ways to encourage clearing members to facilitate their clients' participation)?

FIA PTG agrees that it is important to minimize information leakage in the context of a CCP default auction. However, assertions that client participation will necessarily lead to a greater risk of information leakage compared to clearing member participation are unfounded. For these assertions to be true one would have to assume that clients are more likely to violate the strict confidentiality obligations imposed by CCPs and risk the resultant legal, regulatory, and reputational implications which could be quite material.

As we detailed above, we would expect that client default auction participants would be pre-approved by the CCP and their clearing member to participate in the auction. Accordingly, we expect that a clearing member that approved their client to participate in a specific default auction would have the necessary risk management expertise to handle any portfolio that would come from that auction.

a. One option for addressing a disparity in incentives between clearing members and clients is to require clients to contribute an established amount to the default fund prior to participating in an auction. What are the implications of this requirement (such as regulatory, economic or contractual implications) and how can a CCP address these implications?

FIA PTG believes that for clients to participate in CCP default auctions they should not be required to contribute to the CCP default fund. Contributing to the default fund is one of the most significant costs associated with direct clearing membership. Imposing this requirement on clients would significantly impede client participation in auctions and is not necessary to ensure responsible client participation.

We strongly disagree with any suggestion that clearing member and client incentives are misaligned with respect to auction participation. Both risk incurring financial damage should a CCP fail or utilize other default management tools and both may enjoy the financial upside of successfully winning an auction portfolio in particular:

- Clients, like all CCP participants, have a strong interest in seeing the CCP remain solvent.
- Client incentives are perfectly aligned with clearing members in wanting to see a successful default auction at the lowest possible cost to the CCP given that an auction failure would likely result in the CCP utilizing other default management tools, which negatively impact all CCP participants.