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To: OSE Market Planning Department / TOCOM Business Operations
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Dear Sirs/Madams

Consultation on the Introduction of Derivatives Holiday Trading by OSE and TOCOM

FIA[1] appreciates the opportunity to respond to the proposals (collectively, the "**Proposals**") set out in the "Introduction of Derivatives Holiday Trading" issued by Osaka Exchange, Inc. (OSE) and Tokyo Commodity Exchange, Inc. (TOCOM) (collectively, the "**Exchange**") on 15 June 2021.

In general, we believe that all elements of the Exchange and Clearing House should function as much as possible if the Exchange and the CCPare going to be open for executing and clearing new trades through a holiday period so that effective risk management can take place like an ordinary business day. This will enable risk reducing trades to take place and additional collateral to be provided at all times.

Some members have expressed concerns that the current Proposals could inhibit their participation in holiday trading due to the level of risk that participants could be exposed to. To encourage higher levels of participation by members, we respectfully put forward some alternative proposals (in order of preference) for consideration by the Exchange:

1. Variation Margin and Initial Margin to be called on a daily basis in a currency different to the 'holiday' currency, in line best practices across other CCPs in APAC. This will allow for appropriate risk management to take place.

2. MPOR to be increased for the Initial Margin requirements for all positions prior to the holiday, in line with the length of the holiday. This should be called against the client and house account and passed to end users. To give Holiday Clearing Participants (**HCPs**) sufficient time to call clients for the additional margin, any increase should also be advised in a timely manner (e.g. at least one day in advance).

3. Each HCP (or split between client and house trading) to be allowed to have pre-agreed holiday trading limits defined by Initial Margin. Please see item 2(a) (*Ability to Opt In at Client Level*) for more details.

[1] FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry. FIA's mission is to support open, transparent and competitive markets, protect and enhance the integrity of the financial system, and promote high standards of professional conduct. As the principal members of derivatives clearinghouses worldwide, FIA's member firms play a critical role in the reduction of systemic risk in global financial markets. Further information is available at www.fia.org.

We also wish to highlight some specific comments for consideration by the Exchange. Unless otherwise defined, capitalised terms used in this letter will bear the same meanings ascribed to them in the Proposals.

1. Margin and Collateral Posting

a. Application and Allocation of Preliminary Initial Margin Add-On

The Exchange intends to apply initial margin to both house and client positions but fully allocate it to the house account. This means that even if HCPs receive funds from clients that wish to pre-fund their holiday trading, HCPs will be unable to utilise these funds as client money rules prohibit them from using the client funds to meet a house margin call. HCPs will therefore need to source 'house collateral' to meet the margin calls. This results in additional funding costs for HCPs and could also attract additional capital charges.

Such a prefunding solution against the house account is also contrary to the "end user pays" principle as any CCP default risk is transferred from clients to HCPs throughout the holiday period. In the global futures space, clearing members do not typically guarantee the performance of the CCP to its end clients.

HCPs could also be forced to reduce the number of trades they can enter into. To manage their counterparty exposure, clearing members will set limits for the total collateral that they will post to a CCP at a client and house level. Where HCPs are required to fund 1.6x initial margin for house and all clients, it is likely that these internal limits will be breached. This will force larger HCPs to reduce business in order to stay within these holiday limits.

b. Stale Pricing and Absence of Daily Mark-to-Market

Use of Stale Pricing for IM Methodology
The Exchange intends to calculate the margin buffer for holiday trading based on the day immediately preceding the Business Day Before Holiday Trading Day (H-2). We encourage the Exchange to establish a robust pricing mechanism instead of relying on H-2 pricing. As seen in March 2020, the IM increase at the contract level can far exceed 100%. The add-on margin may therefore be insufficient to cover the additional risk over the holiday period.

The Exchange also intends to base the add-on margin methodology on a fixed rate (30% for 1 day, 45% for 2 days and 60% for 3 days). We seek clarity from the Exchange on (i) the basis for such percentages and (ii) the applicable percentages for holidays periods longer than 3 days (For example, Golden Week).

We also ask the Exchange to provide assurance to HCPs that the pre-funded amount is adequate to cover potential adverse price movements over consecutive holidays in the absence of a variation margin call during this period.

Absence of Daily Mark to Market
The Exchange has noted that there will not be determination of settlement prices, a settlement of VM/OP premium and update of initial margin requirements during holiday period.

Pre-funded initial margin add-on reduces the risk stemming from price movements only partially and not fully. As mentioned above, recent market volatility has shown that prefunded resources may not be sufficient if market moves are sufficiently large. Variation Margin typically reacts first and accounts for the largest bulk of payment calls. The size of the VM moves over a holiday period could exceed the IM amount that has been deposited. Without collecting VM on a daily basis, it will be difficult for the Exchange to determine if a HCP is at risk of default.

As such, we recommend that trades carried out during the holiday period should be subject to daily mark-to-market and for VM to be called in an alternative currency to JPY. This is to allow so appropriate risk management can take place by ensuring that there is no unnecessary build-up of risk.

In addition, HCPs that do not participate in holiday trading will not be required to prefund their initial margin. Therefore, positions of non-holiday participants would not have been risk managed throughout the holiday period and no IM buffer would be available to cover any potential moves. Such members will see large VM calls on the first business day after the market opens at the scheduled emergency margin or latest at the end of the day.
To avoid any under-collateralization of risk after the end of holiday period, we recommend collecting sufficient collateral from non-holiday participants to collateralize the risk stemming from price moves during holiday period. To achieve this, the Exchange could consider collecting margin buffer on the business day prior to holiday or making a margin call for all members at the start of the ordinary day following the end of holiday trading period. This would ensure that the CCP has adequate margin at the start of ordinary trading day based on price moves during the holiday period.

The absence of daily EDSPs published by the CCPs would also make it difficult for HCPs who would like to risk manage clients through VM calls on a daily basis through the holiday period in an automated fashion.

c. Currency of Margins

The Exchange will require additional margins to be posted on the next day of holiday trading. However, there are no solutions for clearing members to swift JPY cash during bank holidays in case of sequence holidays.

We therefore ask the Exchange to consider that IM and VM be called on a daily basis in an alternative currency to JPY. This will also allow for appropriate risk management to take place.

For posting collateral on holidays, we understand that the Exchange has been exploring options like "Real time account transfer/Ultra deposit" for cash collateral and Euroclear for bond collateral posting. We ask the Exchange to share any further updates on this topic. This would help members in planning the collateral posting during holiday, in particular posting collateral in USD (non-JPY currency) and arrangements with settlement banks that support collateral posting on Japanese holiday.

d. HCP Monitoring Framework

The Exchange has noted various risk monitoring measures for holiday trading participants such as risk/collateral ratio, emergency margin, 4pm judgement call for checking collateral sufficiency. The Exchange will also require members to post additional collateral if collateral deposited proves to be insufficient by 11am next day.

The Exchange uses prior business day's closing price for monitoring throughout the holiday period. This might not reflect true risk as futures prices are expected to change with trading being active during holiday. As aforementioned, we encourage the establishment of a robust pricing mechanism and monitoring framework based on such pricing mechanism.

We also request that the Exchange consider introducing an active monitoring and notification system so members are aware and can take appropriate action in advance of reaching risk collateral ratio of 100%. For example, the concerned member could be notified when the ratio reaches 80%, be prompted to initiate risk reducing trades upon reaching 90% and be suspended as soon as the ratio reaches 100%. Unless the member is trading risk reducing positions, we do not recommend that the Exchange waits until 11am next day to suspend trading under any other scenario.

e. Treatment when Failing Resolution of Risk Excessiveness

The consultation notes that "when an occurrence of a settlement failure is unlikely in respect of the Holiday Clearing Participant subject to the suspension of clearing related to holiday trading, clearing for the relevant Holiday Clearing Participant on and after the next ordinary business day following the Holiday Trading Day shall be performed normally".

We request more information around how the Exchange will determine that a failure is unlikely. As a member is not required to fund margin prior to novation, we recommend against allowing such member to clear normally after the end of holiday period. We ask the Exchange to consider instead requiring the suspended member to collateralize or risk reduce its positions before resuming normal clearing activities after the end of holiday trading period.

2. Product Scope and Participation

a. Ability to Opt In at Client Level

The consultation notes that a HCP can exclude customers that are not participating in holiday trading from IM add-on. This is subject to HCPs taking steps to restrict these clients' trading activities during holidays and the Exchange's approval to such exclusion.

The illustration provided in the consultation document (*Reference 1*) relates to clients in an individually segregated model. We seek the Exchange's guidance on how clients in non-individually segregated account structures can exercise the opt out option given that all the clients for products under scope for holiday trading are operationally comingled as per the Q1 PFMI Quantitative Disclosures.

We also seek more clarity around the factors the Exchange takes into consideration when determining whether to grant such approval.

As mentioned above, as the IM add-on for clients is treated as house IM, the same cannot be funded from client collateral thus making it very expensive for a HCP to fund holiday trading related IM add on. We therefore ask the Exchange to consider a mechanism for allocating margin add on at client level.

Alternatively, we suggest that the Exchange consider allowing each HCP (or split between client and house trading) to have pre-agreed holiday trading limits defined by Initial Margin. This would allow firms to participate based on different sizes of their choosing which in turn would result in a greater level of participation in holiday trading. Further this aligns the capacity to holiday trade with pre lodged collateral, which is more highly correlated as compared to a multiplier on the entire book which may be less of a representation of clearing member trading over holidays potentially reducing the incentive to participate.

b. Suitability of Options

Some of our members have expressed concerns around the suitability of options for holiday trading given the absence of daily MTM and potentially limited IM for longer periods.

c. Market Maker Program

We seek more clarity around the operation of the market maker program during the holiday period.

3. Clearing Not Operational During Holiday Period

We understand that the Exchange will not accept applications related to clearing matters (give-up, position report, etc.) on holidays, and will accept them only on weekdays. We seek further details around the management of an execution only position over a holiday period (for example, which party gets margined).

We also encourage the Exchange to consider all possible scenarios (for example, a close out trade for a client with an offset at the client Clearing Broker) and provide members with more details on how these will be handled.

4. Default Management

a. Measures in Case of Settlement Failure on Holiday Trading Day

The consultation notes that if a member fails during the holiday trading period, such member's suspension and the initiation of default management process is done on the business day following the holiday trading day.

We recommend that the Exchange suspends the defaulting member immediately and notifies the market as soon as practicable. This is especially when the holiday period exceeds one day.
We understand that not all clearing members would be available during the holiday period and other markets/exchanges (for e.g. TSE for Cash equity securities) would be closed. This would

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mean that the Exchange would not be able to initiate close out of all contracts in the defaulted member's account and hence, default management processes cannot be initiated.
However, we ask that the Exchange takes all reasonable efforts to ensure that the defaulted member does not bring any additional risk to the market.

b. Compensation of Loss arising from Settlement Failure related to Holiday Clearing Participant's Holiday Trading

As per the consultation, the Holiday Trading Reserve contributed by the Exchange is available only when the failure is driven by holiday trading.

As defaults could happen on ordinary business day owing to trades executed during the holiday period, we seek clarity from the Exchange on how it can establish that the default relates to holiday period related trading only. We recommend that the Holiday Trading Reserve be available in all instances when a holiday trading participant defaults.

We also seek further information on size of the Holiday Trading Reserve and the basis of its sizing.

5. Other

a. Business days vs. Calendar days

The Exchange has noted that holiday trading days will not be counted towards the 30 days' notice period and default settlement period.

The existing rules such as Article 76-2 (Setting Default Settlement Period - capped period) and Article 26-2 (Member withdrawal) indicate the use of calendar days rather than business days. We recommend that the rules are consistent, for example by making a reference to business days while expressing length of time period (e.g. default settlement period of 22 business days instead of a period of 30 days).

b. Requests for Clarification

Our members seek clarification on the following:

i. What is the cut-off time for calculating the add-on margins before the holiday, timing for participating clearing members to receive add-on margin calls, and deadline for settling the add-on margins?

ii. For the Risk Collateral Ratio (RCR), how is the 'Risk' exposures being calculated?

iii. Is there any juniorization mechanism in the default waterfall for holiday clearing participants?

iv. Does applying to be a Holiday Trading Participant automatically mean that the member is a Holiday Clearing Participant as well or are they two separate applications?

v. What happens if a trade executed on a holiday is to be given up to a clearer that is not a Holiday Clearing Participant?

We welcome the opportunity to work with the Exchange to address these comments before the implementation of the Proposals.

Please feel free to contact me at bherder@fia.org or TzeMin Yeo, Head of Legal & Policy, Asia Pacific at tmyeo@fia.org should you wish to further discuss.

Yours

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