

David A. Stawick, Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, NW  
Washington, DC 20581  
United States  
[www.cftc.gov](http://www.cftc.gov)

Chris Barnard  
Germany

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- **17 CFR Parts 39 and 140**
- **RIN Number 3038-AC98, 3038-AD02**
- **Financial Resources Requirements for Derivatives Clearing Organizations**

Dear Mr. Stawick.

Thank you for giving us the opportunity to comment on your notice of proposed rulemaking: Financial Resources Requirements for Derivatives Clearing Organizations.

You are proposing rules to implement new statutory provisions enacted by Title VII and Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). The proposed regulations establish financial resources requirements for derivatives clearing organizations (DCOs) for the purpose of ensuring that they maintain sufficient financial resources to enable them to perform their functions in compliance with the Commodity Exchange Act and Dodd-Frank.

#### Financial resources requirements

I support your proposals, which should act to improve the robustness of clearing systems and help to protect the financial system from contagion. However, I do not think that the proposals go far enough. We have to anticipate and work with the “tail-risk” conditions which would be expected to apply in the event of the default of a significant clearing member. Default of a significant clearing member would almost certainly occur in conditions of financial uncertainty and stress. Such conditions could be accompanied by reduced liquidity and funding, widening spreads, falling solvency and increasing defaults and other systemic impacts. The DCO would also need resources to continue operating and to satisfy the additional expectations of its clearing members post-default. For this reason I would

recommend that the proposed financial resources requirements for a DCO should be significantly in excess of those required “to meet its financial obligations to its clearing members notwithstanding a default by the clearing member creating the largest financial exposure for the DCO in extreme but plausible market conditions”.<sup>1</sup>

I would also recommend that consideration should be given to differentiating risk and therefore resource requirements by broad derivative / product class, or at least by exchange-traded and OTC derivative types. OTC derivatives tend to be more complex, less transparent and less liquid, which presents greater problems to the DCO compared with exchange traded derivatives.

### Types of financial resources

Proposed Regulation 39.11(b)(1) lists the types of financial resources that would be available to a DCO to meet its financial obligations to its clearing members as: (1) the margin of the defaulting clearing member; (2) the DCO’s own capital; (3) the guaranty fund deposits of the defaulting clearing member and non-defaulting clearing members; (4) default insurance; (5) potential assessments for additional guaranty fund contributions on non-defaulting clearing members; and (6) any other financial resource deemed acceptable by the CFTC. I would suggest splitting these financial resources into two classes. Class A would consist of (1) to (3) above, and should be required to make up the significant part of the total financial resources, and class B would consist of (4) to (6) above, on which larger prudential haircuts should be applied. Care should be taken with (4), as default insurance may be particularly unreliable in times of financial stress, and we should be more careful not to anticipate (5) excessively, as this may cause pro-cyclical problems and increase systemic risk in times of financial stress.

### Computation of the financial resources requirement

I agree that stress testing should be carried out at least monthly, with the possibility to require more frequent testing in times of increased volatility, reduced liquidity or general conditions of financial stress. Backtesting should be carried out daily. I would also suggest that you should specifically refer to reverse stress testing in proposed Regulation 39.11(c)(1). This is a useful tool in order to manage expectations and to help the DCO to anticipate financial resources requirements in extreme conditions.

### SIDCOs

Given their aggregate nature and high levels of interconnectedness, I would therefore argue that all DCOs are SIDCOs.

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<sup>1</sup> This would also be consistent with principle 4 in the latest CPSS-IOSCO consultative report on Principles for financial market infrastructures - March 2011, which states that: “A CCP should also maintain additional financial resources to cover a wide range of potential stress scenarios that should include, but not be limited to, the default of the [one/ two] participant[s] and [its/their] affiliates that would potentially cause the largest aggregate credit exposure[s] in extreme but plausible market conditions”.

Summary

I believe that we can improve on these proposed rules and increase their positive impacts on the market. I would specifically recommend higher and more risk-targeted financial resource requirements for DCOs, and that the types of financial resources available should be segregated into broad classes depending on their availability and robustness. Given their key role, I would further argue that all DCOs are, or should be classed as, SIDCOs.

Yours sincerely

Chris Barnard