Comments to Public Consultation on Outlines related to Listed Derivatives Clearing Service

On January 30, 2020, JSCC published "Outlines related to Revision of Loss Compensation Framework and Risk Management Framework for Listed Derivatives Clearing Services," "Outlines concerning Commodity Market Clearing Service in association with Integration with Japan Commodity Clearing House Co., Ltd." and "Outlines related to Revision of Emergency Margin Framework for Listed Derivatives Clearing Services" for public consultation and solicited comments by February 29, 2020.

Summary of the comments received by JSCC and JSCC's response are as follows:

#	Comment Summary	JSCC's Response
	I. Outlines related to Revision of Loss Compensation Framework and Risk Management Framework for Listed Derivatives Clearing Services	
	1. Revision of Loss Compensation Framework under Listed Derivatives Clearing Services	
	(1) Revision of Loss Compensation Financial Resources	
1	• We view that this new Loss Compensation Framework and Risk Management Framework for Listed Derivatives Clearing Services is a very positive improvement.	• We appreciate these comments and understanding.
2	• FIA commends the steps JSCC intends to take to revise its loss compensation framework upon the default of a clearing member for its Listed Derivatives segment, in particular for setting a cap on the Special Clearing Charge. We also appreciate the establishment by JSCC of an industry working group to discuss measures to enhance the risk management practices in the listed derivatives segment.	
3	• We would like to suggest a meaningful proportion of the DF in comparison to the Skin in the game in order to balance risk incentives between clearing members and JSCC. JSCC's new risk management did not revise the SITG which currently covers approx. 14.5% (as of Sep 2019 from JSCC and exchanges for both Listed Derivative and Listed Securities market) of the prefunded DF, which is moderately higher compared to global CCPs, but we would like to see more contributions from JSCC.	• JSCC regularly validates the level of the settlement guarantee reserve, which JSCC contributes as a part of the Loss Compensation Financial Resources for each Clearing Service, taking into account the level of the clearing fund requirement for an

#	Comment Summary	JSCC's Response
		average Clearing Participant as well as other factors.
	(2) Handling of Survivors' Clearing Fund Contribution (4th Priority Resource)	
4	• We note that each commodity product will have its own Default Fund. In the unlikely event a product specific Default Fund is insufficient, will the DF of other commodity products be available to absorb such residual losses? If so at what sequence of the waterfall (see page 51/57)	• The Clearing Fund for Commodity Derivatives will be established separately for each Clearing Qualification described in Section 2. (1) of "Outlines concerning Commodity Market Clearing Service in association with Integration with Japan Commodity Clearing House Co., Ltd.," and the Clearing Fund deposited by a non-defaulting Clearing Participant will never be used to cover losses under another Clearing Qualification. • Incidentally, the Clearing Fund deposited for each Clearing Qualification by a defaulting Clearing Participant would be applied to offset losses arising from the default separately for each Clearing Qualification, and any excess amount remaining after the default is resolved, if any, would be used to

<table>
<tr><th>#</th><th>Comment Summary</th><th>JSCC's Response</th></tr>
<tr><td></td><td></td><td>cover losses under other Clearing Qualifications, as detailed in "① Margin, Clearing Fund, etc. for Proprietary Account of Default Clearing Participant" under Section 16. (2).</td></tr>
<tr><td></td><td colspan="2">(3) Handling of First Special Clearing Charge (5th Priority Resource)</td></tr>
<tr><td>5</td><td>• Under JSCC's new risk management, additional assessment will be capped at 3x, which is definitely preferable to uncapped. However, multiple cash calls is not ideal for the purpose of limiting the pro-cyclical effect of assessments, which may potential lead to systemic risk or a liquidity crunch. We acknowledge that JSCC / regulators view x3 as appropriate and necessary for additional financial resource in order to introduce capped liability, but we would like JSCC to consider lowering the number of assessment in the long run.</td><td rowspan="2">• The revision of the Loss Compensation Framework at this time, including the level of the First Special Clearing Charge, is a result of discussions at the Working-Group on Revision of Loss Compensation Framework for Listed Derivatives (members comprised of domestic and foreign financial institutions) established in September 2019 under JSCC's Listed Products Management Committee (JSCC Board advisory committee). As a result of the Working-Group discussions, and taking into consideration the loss compensation framework in Japan, with the basic policies that ① loss recovery by the Second Special</td></tr>
<tr><td>6</td><td>• We commend JSCC's proposals to introduce a default fund cap and acknowledge that JSCC views 3x as an appropriate and necessary additional financial resource in order to introduce capped liability. However, we suggest 1x for the purpose of limiting the pro-cyclical effect of assessments, enabling Clearing Participants to measure and manage their exposures, and to reduce the likelihood that the additional assessments lead to systemic risk or a liquidity crunch.</td></tr>
</table>

#	Comment Summary	JSCC's Response
		Clearing Charge and the Partial Tear-up (which may have an impact on investors) should be avoided as much as possible, and ② robustness of the loss compensation framework is important for a Japanese CCP to avoid systemic risk, and taking into consideration the level of assessments adopted by overseas CCPs, Working-Group members agreed that the level of the First Special Clearing Charge at 3 times the clearing fund requirement is appropriate.
	(4) Handling of Second Special Clearing Charge (6th Priority Resource)	
7	• With respect to the application of VMGH we continue to stress that JSCC is to ensure that it will share at the most granular level possible, which amounts it has cut over the various accounts of a member. This would enable member to pass on such losses to the client level.	• JSCC calculates the amount of the Second Special Clearing Charge by prorate, based on the gains of each In-the-Money Participant whose net VM-OP Premium Equivalent for all accounts, both House and Client, is positive (See Annex 2 to "Outlines related to Revision of Loss Compensation Framework and Risk Management Framework for Listed Derivatives Clearing Services").

#	Comment Summary	JSCC's Response
		• JSCC would then ask each relevant Clearing Participant to pay such amount to JSCC.
	(5) Collateral Posting during Default Settlement Period	
8	• The timeline for returning the default contingent margin is not clear from the consultation. We would appreciate if JSCC could give more details around it.	• Default Contingent Margin may arise during the Default Settlement Period, and the deposit obligation would extinguish, with the funds returned, at the time the Default Settlement Period ends.
9	• The DCM will only increase or remain flat but cannot be reduced even if the surviving Clearing Participant's clearing position has largely decreased. Given the rule on default settlement period, there is currently no certainty about when the DCM would be returned to the surviving Clearing Participants in the case of multiple defaults. We request that the JSCC provide clarity around when the DCM will be returned.	
	2. Revision of Liquidation Scheme upon Settlement Failure in Listed Derivatives Clearing Services	
	(1) Liquidation of Defaulted Contracts (Position) of Defaulter	
10	• We request JSCC to provide more clarity around the auction procedures. This is because outcome of the auction determines utilization of VMGH and application of PTU.	• Precise auction procedures will be discussed going forward and will be provided to Clearing Participants at the appropriate time.
11	• Given that a 'successful' auction is a key to prevent partial tear-ups, it is important that Clearing Participants have enough visibility about the defaulted portfolio and reasonable turnaround time to make the bidding decision. As the planned implementation date for the new framework is July 2020, can JSCC advise on when it intends to commence consultation of the auction rules?	
12	• JSCC proposes that for the commodities segment, the auction related to the contracts to be settled by delivery will be conducted at a price range of +/-10% to the base price determined based on the latest settlement price. Given that bid-offer may widen in stressed market situation, it is not plausible to set a price buffer. We therefore request that JSCC explain its rationale for setting this price range.	• Under the prevailing rules of Tokyo Commodity Exchange, the additional compensation for liquidation of a defaulting delivery position is set at

#	Comment Summary	JSCC's Response
		10% in general and has been accepted by existing market players. • In light of this, JSCC decided to adopt the same procedures following the integration. • However, the level of 10% is a general rule, and when JSCC considers it necessary by taking into consideration the prevailing market conditions and loss compensation financial resources, JSCC may set a higher level.
	(3) Partial Tear-up	
13	• We suggest JSCC clarifies how it will apply PTU. We would need clarity as to whether JSCC expects members to indicate which contracts are to be torn up after CCP's indication as to how many of a member's contracts on an aggregate basis are subjected to PTU.	• Partial Tear-up Allocated Position will be decided by JSCC, at the account level, for the relevant Clearing Participants, in accordance with the method described in "Outlines related to Revision of Loss Compensation Framework and Risk Management Framework for Listed Derivatives Clearing Services" and its Annex 4. • Clearing Participants would not need to submit information on position

#	Comment Summary	JSCC's Response
		subject to the early termination under the relevant account to JSCC.
	3. Revision of Clearing Fund Framework related to Listed Derivatives Clearing Services	
	(1) Clearing Fund Requirement	
14	• The Clearing Fund is sized to cover the default of the largest member and the five weakest members in terms of net worth falling short of the standard Cover-2 principle (in the commodity derivatives market). We would recommend to adopt the Cover-2 standard to ensure consistency with JSCC Listed Derivatives. Furthermore, the Clearinghouse should fully disclose its stress testing framework for commodity derivatives and re-size the Clearing Fund on a quarterly basis.	• We expect to see the gradual development of the Commodity Derivatives Market due to an increase in the number of market participants following the transfer of some products to the Osaka Exchange. Therefore, JSCC decided to partially adopt the same risk management framework for Commodity Derivatives as those currently adopted for financial derivatives, as a transitional measure to limit the level of significant change. • Whether to continue with, or abolish, the relevant transitional measures will be considered in the future, based on the conditions of the Commodity Derivatives Market. • JSCC's framework for stress testing is stated in JSCC's PFMI disclosure documents.

#	Comment Summary	JSCC's Response
	II. Outlines concerning Commodity Market Clearing Service in association with Integration with Japan Commodity Clearing House Co., Ltd.	
	2. Clearing Participant Framework	
15	• We note that the proposed resignation procedure deviates from what is proposed in the Listed Derivatives segment in the sense that approval for resignation is required and would therefore make the Commodities segment an un-capped market as well. We strongly suggest that JSCC harmonizes the membership renunciation rules in line with what is proposed in the Listed Derivatives segment. Note that generally we cannot become a member of an uncapped liability market (see page 10/57 of attached doc).	• In light of the comments, JSCC will adopt the same Clearing Qualification renunciation procedures for Commodity Derivatives as for financial derivatives.
	10. VM/OP Premium Settlement Method	
16	• There seems to be a 2 hour time gap between pay in of margin and pay outs by the CCP. This gap seems very wide and we would ask JSCC to narrow or close this gap as much as possible (see page 25/57)	• VM/OP Premium is to be settled on a net basis for Commodity Derivatives as well as for existing financial derivatives, such as index futures. Therefore, the settlement timing is being harmonized with the timing used for existing financial derivatives. • The two-hour time gap for financial derivatives is set as a realizable time, taking into consideration the time required for operations, including financial infrastructures.
	11. Final Settlement	
17	• The Outlines states that "In case where the Clearing Participant who becomes a party to the delivery fails to conduct the delivery by the delivery day, the settlement shall be performed by payment by the relevant Clearing Participant of money to JSCC and payment of such	• We expect to adopt the same method as the current Tokyo Commodity Exchange rules.

#	Comment Summary	JSCC's Response
	money to the counterparty to the delivery." What is JSCC's view on how to decide the amount of such money? Would the treatment be the same as those under Article 47, Paragraph 3 of the Market Rules of Tokyo Commodity Exchange?	
	13. Margin	
18	• The one day Margin Period of Risk (MPOR) falls short of best industry practice. We would recommend to apply at least a 2-day MPOR for commodity derivatives taking into account the liquidity profile of these products and to ensure consistency with the revised 2-day MPOR at JSCC's Listed Derivatives segment effective in September 2020.	• We expect to see the gradual development of the Commodity Derivatives Market due to an increase in the number of market participants following the transfer of some products to the Osaka Exchange. Therefore, JSCC decided to partially adopt the same risk management framework for Commodity Derivatives as those currently adopted for financial derivatives, as a transitional measure to limit the level of significant change. • Whether to continue with, or abolish, the relevant transitional measures will be considered in the future, based on the conditions of the Commodity Derivatives Market.
19	• The proposed lookback period of up to 54 weeks is much shorter than best practice. As a result, margin could be pro-cyclical and insufficient. Margin should be calibrated using a set of scenarios that capture a wide diversity of scenarios. For most F&O products a lookback of at least 10 years should be employed. At the very least, the Clearinghouse should apply a 5-year lookback to ensure consistency with the revised lookback applied at JSCC's Listed Derivatives segment effective in September 2020.	
20	• Products listed on the Osaka Dojima Commodity Exchange (ODE) are exempt from Intra-day Margin, Emergency Margin and Emergency Margin for Specified Party as well as Liquidity	• Products listed on Osaka Dojima Commodity Exchange will be out of the scope of the frameworks of

#	Comment Summary	JSCC's Response
	and Concentration add-on margin. We would encourage the Clearinghouse to apply the same standard for products listed on ODE.	Intraday Margin, Emergency Margin, Emergency Margin for Specified Party and Increasing Margin Requirement according to Risk Amount, taking into consideration the trading volume and operational burden on the Exchange. This is because the frequency of trade data provided by the Exchange is limited. • JSCC will continue discussions with parties involved, with the aim of covering products listed on Osaka Dojima Commodity Exchange under these frameworks in the future.
21	• We recommend to limit eligible collateral to liquid products, establish a minimum cash requirement and effective concentration limits to prevent members from posting collateral solely in one asset class.	• To realize the expected value upon liquidation of a defaulter's collateral, for existing financial derivatives, JSCC limits acceptable collateral to liquid products, conservatively sets haircuts, and manages collateral paying particular attention to concentration risk. • Specifically for the Clearing Fund, JSCC requires Clearing Participant's cash (JPY) deposit to equal at least

#	Comment Summary	JSCC's Response
		half of the Clearing Fund requirement minus JPY 1 billion. • JSCC also imposes restrictions on the type and quantity of eligible collateral according to feature of each account, such as not allowing deposits of stocks exceeding 2% of issued and outstanding shares, for a house account and its affiliates. • We will adopt these same restrictions, currently in place for Listed Derivatives, to Commodity Derivatives.
22	• Tighten the timeline to settle EOD margin payments to mitigate the risk of uncollateralized trades between opening and the time margin payments are received.	• Current timing is set with an acknowledgement of the fact that a shorter timeline would be desirable from risk management perspective, and considering the time required for the required operational procedures to be completed by Clearing Participants, from the notification of the Margin requirement to deposit.
	III. Outlines related to Revision of Emergency Margin Framework for Listed Derivatives Clearing Services	
23	• We suggest that JSCC considers an operational threshold beyond which they would call the emergency margin in order to avoid having to call members for an insignificant amount of	• In order to avoid issuing an Emergency Margin call for only a

#	Comment Summary	JSCC's Response
	funds. The operational threshold may be defined as an absolute amount and/ or as a % of the margin requirement.	small change in the requirement, JSCC only calls for Emergency Margin when the Emergency Margin requirement exceeds the latest Clearing Participant House Margin by JPY 10 million (the same level that applies to Intraday Margin.).
24	• We would recommend that JSCC increases the frequency of emergency margin calculations and shortens the timeline an emergency margin shortfall is collected.	• With the Emergency Margin for Specified Party framework, JSCC always calculates the Risk Amount, etc. at a high frequency, and calls for this margin from the party whose exposure is excessive when compared to financial strength and posted collateral balance.
25	• We are of the view that by amalgamating the Emergency Margin with the principles of the Intraday Margin, JSCC intraday margining framework could be further streamlined.	• Emergency Margin is calculated following a sudden fluctuation in the market, whilst Intraday Margin is calculated on a daily basis. However, the underlying concept, including the calculation method, is the same.
26	• Emergency Margin should be charged at segment level. However, it is not clear from the Proposals if Emergency Margin will be charged to all Clearing Participants across the	• When the Emergency Margin threshold is breached for a certain product, an Emergency Margin call is

#	Comment Summary	JSCC's Response
	Securities and Commodities segments. We therefore request JSCC's confirmation that the Emergency Margin will be charged at segment level.	triggered for all Clearing Qualifications. • In this case, in the same manner as an ordinary Initial Margin calculation and Intraday Margin calculation, the Emergency Margin requirement would be re-calculated separately for products covered by the Financial Instruments and Exchange Act and those products covered by the Commodity Derivatives Transaction Act, and whether or not additional deposit is required would be determined. • The Emergency Margin framework under the Financial Instruments and Exchange Act covers some Commodity Derivatives (Commodity Derivatives on precious metals, rubber and agricultural products listed on Osaka Exchange).

Comments Submitted from: 1,3,5 = Goldman Sachs Japan; 4,7,8,10,13-16,18-25 = JP Morgan Securities Japan; 2,4,6,9,11,12,15,23-26 = FIA; 17 = Individual

End of Document