GCSA

September 23, 2013

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Re: Consultative Report on the Recovery of Financial Market Infrastructures

Ladies and Gentlemen:

GCSA LLC appreciates the opportunity to provide comments to the Committee on Payment and Settlement Systems of the Bank for International Settlements ("CPSS") and the Board of the International Organization for Securities Commissions ("IOSCO") in response to the Consultative Report on the Recovery of Financial Market Infrastructures ("Consultative Report"). GCSA is a specialized program manager and claims manager of insurance products for financial institutions and financial market infrastructures ("FMIs").[1] GCSA has partnered with Lockton Companies (the largest private insurance broker in the world) to assemble a consortium of leading global insurers (the "GCSA Consortium") to provide insurance as a cost-effective financial resource and recovery tool for FMIs.

The GCSA Consortium consists of financially sound, highly rated, multiline insurers from around the world, representing an estimated total assets of $400 billion and estimated annual claims paying ability of approximately $300 billion. In order to minimize systemic inter-connectedness in relation to FMIs, the GCSA Consortium does not include insurers that are clearing members, or affiliates of clearing members, of FMIs. The GCSA Consortium is further diversified by limiting the concentration risk that any one insurer can bind for a single deal and

[1] GCSA's wholly-owned subsidiary, GCSA Partners LLC, is licensed in the State of New York as a Property/Casualty Broker, Property/Casualty Agent, and as a Surplus Line Broker.

ensuring that each insurer's aggregate exposure across the portfolio is appropriate relative to its claims-paying ability.

As CPSS-IOSCO is well-aware, FMIs – most notably, central counterparties ("CCPs") – play a central role in managing systemic risk but can also concentrate significant levels of financial risk. This is particularly the case as more of the nations of the world implement mandatory clearing requirements for certain OTC derivatives transactions. It is therefore critical that FMIs maintain sufficient financial resources and tools to enable them to recover from threats to their viability and financial strength and enable them to continue to provide services to the markets they serve.

In light of the critical role FMIs play in the financial markets, GCSA commends CPSS-IOSCO for urging FMIs to adopt a comprehensive and effective set of recovery tools. We further commend CPSS-IOSCO for recognizing the role that insurance can play in strengthening FMI viability. As the Consultative Report observes, an FMI may need to have "explicit insurance or indemnity agreements" in place "to cover losses relating to general business, custody and investment, or operational risks which may cause an FMI to experience an extraordinary one-off loss or recurring losses."[2] In addition, we believe that a balanced consortium of global insurers can provide ex-ante agreements to (i) absorb a portion of extreme losses caused by member defaults, (ii) help to replenish FMI financial resources in recovery scenarios, and (iii) provide other types of coverage to absorb a portion of losses not related to participant defaults.

The benefits of including the financial strength of the global insurance industry as part of an FMI's overall package of recovery tools are multifold. The insurance industry is capable of providing true risk transfer that does not need to be repaid in times of financial stress. When appropriately structured to minimize systemic interconnectedness, insurance can also promote the laudable goal of employing recovery tools with the least negative systemic impact. Unlike CCP members faced with potential assessments, margin haircuts, forced allocations and/or tear-ups, the global insurance industry is well-positioned to absorb significant losses and provide funds to recapitalize a CCP without creating "wrong-way risk" or potential contagion among market participants. Decreasing the financial burden on non-defaulting CCP members during a financial crisis, and thus minimizing the possibility of "cascading" clearing member defaults, will minimize negative effects on the CCP, interconnected FMIs, market participants and the financial system as a whole.

[2] Consultative Report, ¶ 3.8.1, p. 22.

Insurance can also be utilized to bolster appropriate incentives for FMIs and market participants. By placing insurance in a CCP's "waterfall" of financial resources at a level above the CCP's "skin in the game" contribution (which, in essence, can function as a form of self-insured retention) and clearing members' guaranty fund contributions, CCPs' and clearing members' incentives to prevent losses through robust risk management will not be decreased. Indeed, the additional level of review of an FMI policyholder's operational, legal and quantitative risks required as part of the insurance underwriting process may provide additional incentives for FMIs to further strengthen risk management. Additionally, unlike certain proposed forms of recovery tools such as partial tear-ups of open derivatives contracts, insurance is prepaid (through premiums) by the FMI and does not create disincentives to participation in a CCP.

The concept of employing insurance as a financial resource for CCPs is not novel. In its November 2004 "Recommendations for Central Counterparties", CPSS-IOSCO acknowledged the ability of CCPs to diversify their financial resources through insurance and provided guidelines for such insurance usage:

> *4.5.8 A CCP should include only those resources that it can reliably draw on in the event of a default in evaluating the adequacy of its resources. For example, possible payouts from insurance contracts should be counted only if there is high degree of certainty that the terms of the contracts would be payable in the event of a default. The precise circumstances under which a CCP can draw upon any resources that require conditions to be met should be carefully evaluated in judging their contribution to the overall adequacy of resources.*

These objectives are echoed in the Consultative Report, which notes that "the timeliness and reliability" of insurance as an FMI recovery tool "would be subject to a number of factors including the lead time required for having a claim processed and paid…."[3] Pursuant to these objectives, in order to be an effective FMI recovery tool, we believe that an insurance contract should satisfy the following criteria:

[3] Consultative Report, ¶ 3.8.7, p. 23.

1. the insurance should be provided by multiple, highly rated insurers and should not inappropriately concentrate risk in any one insurer;
2. the insurers should be diversified by region and business type wherever possible;
3. the insurers should have requisite internal approvals for expedited claims-payment terms, in accordance with time frames relevant under the FMI policyholder's regulatory regime;
4. the insurers should have a strong history of claims payment and excellent reputations from within the industry;
5. the insurers should have a clear understanding of the FMI policyholder's business and/or work with a team of industry specialists that provides the requisite knowledge base;
6. the insurers should participate in periodic claims "fire drills" with their FMI policyholders, especially those FMIs deemed systemically important by local regulators; and
7. to the extent practicable, the insurers should utilize standardized and transparent policy terms and provide a high degree of certainty to each FMI policyholder and its regulators regarding the precise circumstances upon which the FMI can draw upon its insurance resources.

Operating pursuant to these criteria, the insurance industry is uniquely positioned to furnish a desirable and transparent FMI recovery tool that (i) provides a true risk-transfer mechanism, (ii) injects committed resources from a segment of the marketplace not otherwise likely to be embroiled in problems threatening the viability of an FMI, (iii) helps to minimize potential contingent liabilities of FMI members (thus reducing "wrong-way risk" and pro-cyclical impacts), and (iv) supports appropriate incentives for FMIs and market participants. We also believe CPSS-IOSCO provided important guidance when it advised of the "significant interaction between [its] principles" and that they were "designed to be applied holistically" and "as a set.[4]" As such, FMIs and their regulators should be further encouraged to explore how insurance could best be used in combination with other resources to soften the blow of extreme stress scenarios and strengthen the financial system in a more balanced and sustainable manner.

GCSA and the GSCA Consortium look forward to working in partnership with FMIs and their regulators to provide a program of insurance that can be employed as part of a comprehensive and effective FMI recovery plan. Again, we appreciate this opportunity to

[4] Principles for Financial Market Infrastructure, 1.19, p. 12.

provide CPSS and IOSCO with our comments on this very important matter. We would be pleased to address any questions you may have regarding our submission. Please direct any such inquiries to Timothy Comiskey, Chief Executive Officer, at (212) 376-5589 or tcomiskey@gcsacapital.com; or Christopher Cononico, Founder & President, at (212) 376-5590 or ccononico@gcsacapital.com.

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