

01 February 2019

**Financial Stability Board
Bank for International Settlements
CH-4002 Basel, Switzerland**

Re: CCP12 Response to FSB Discussion Paper entitled, “Financial resources to support CCP resolution and treatment of CCP equity in resolution”

Executive Remarks

The Global Association of Central Counterparties (“CCP12”) is pleased to provide its response to the discussion paper released by the Financial Stability Board (“FSB”) for public consultation on November 15, 2018 entitled, “Financial resources to support CCP resolution and treatment of CCP equity in resolution”.

CCP12 is a global association of 35 members who operate more than 50 individual central counterparties (“CCPs”) globally across the Americas, EMEA and the Asia-Pacific region. CCP12 aims to promote effective, practical and appropriate risk management and operational standards for CCPs to ensure the safety and efficiency of the financial markets it represents. CCP12 leads and assesses global regulatory and industry initiatives that concern CCPs to form consensus views and seeks to actively engage with regulatory agencies and industry constituents through consultation responses, forum discussions and position papers.

CCP12 previously contributed input on the FSB’s papers on “Key Attributes of Effective Resolution Regimes for Financial Institutions” (“Key Attributes”)¹ and “Guidance on Central Counterparty Resolution and Resolution Planning” (“FSB Guidance”)². CCP12 values that the FSB continues to further its work on financial resources to support CCP resolution and treatment of CCP equity in resolution to determine whether additional guidance is needed on these matters.

For convenience and clarity CCP12 has summarized key points in bullet form below that we feel the FSB should take into consideration related to the discussion paper. These points include:

- CCP12 stresses the importance of recognizing that CCPs have already incorporated default management and recovery measures into the rulebook, consistent with regulatory guidance set out by CPMI-IOSCO that share the primary objective of continuity of critical clearing services as stated in the FSB draft guidance. Therefore, any further FSB guidance must recognize the interaction among CPMI-IOSCO guidance and prescribe guidance for reasons to deviate from the rulebook and/or considerations to early intervention in order not to undermine a CCP’s resiliency.

¹ http://www.fsb.org/wp-content/uploads/r_141015.pdf

² <http://www.fsb.org/wp-content/uploads/P050717-1.pdf>

- CCP12 supports establishing principle considerations to guide dialogue when establishing resolution frameworks based on particular jurisdictions. The need for flexibility is crucial as each jurisdiction and market thereto have unique market characteristics. For example, CCPs are structured differently, clear different products, and are subject to different legal and regulatory frameworks. We believe the five-step process is likely to be interpreted as too detailed and prescriptive; rather, we view that any further guidance should be set at high-level steps with the purpose and intent to ensure that it does not interfere with already established recovery and resolution frameworks.
- Further guidance on this subject should focus more on the actions of the resolution authority rather than CCP operations. Consistent with the FSB's stated purpose and intent, CCP12 agrees that any final guidance paper should remain appropriately focused on assessing the financial resources available in a CCP's resolution and the treatment of equity in a CCP's resolution. CCP12 is concerned that, as proposed, portions of the FSB's exercise may be insufficiently tailored and could be mistakenly perceived as inviting a re-negotiation of CCPs' existing tools. We believe any further policy should be on the resolution authority itself inventorying current CCP tools and related concerns such as legal basis, enforcement ability, efficient planning, resolution enactment, legal effect of enactment, and other resolution authority specific matters.
- Recovery measures established in the CCP rulebook ex-ante should be followed in their entirety to provide required risk and legal certainty to the market and its participants. The confidence of certainty and continuity provided by the rulebook is paramount, particularly in a stressed market. Where the resolution authority contemplates placing the CCP into resolution prior to completion of (or deviating from) recovery measures outlined in the rulebook, there should be a documented evidence-based reasoning to prove that recovery measures established within the rulebook (as agreed ex-ante by the participants and the regulators) are materially inadequate to achieve stated objectives and/or that other measures would better achieve objectives without sacrificing the sanctity of the no creditor worse off than in liquidation ("NCWOL") safeguard.
- CCP12 supports discussions around the situational complexity of resolution as it pertains to different CCP structures and ownership mechanisms and their financial resources. Variances amongst CCPs are important to consider when resolution authorities consider taking any resolution enactment. It is vital to keep in mind key factors such as ownership characteristics, local corporate laws, other lines of business, and other relevant factors. In particular, resolution should not adversely impact corporate groups or other lines of business that may also be core to the legal entity that houses the clearing service as this could in some cases materially adversely impact other important business lines, clearing services, and/or systematically important financial market infrastructure that may be interconnected to market stability or have a symbiotic relationship with other key financial market functions.
- CCP12 does not support guidance that contemplates exposing the equity of a legal entity that may house the clearing service beyond what is stipulated ex-ante in the rulebook and relevant regulation and legislation. Guidance that states or suggests otherwise stands to materially disrupt critical incentives incorporated into CCP rulebooks, thereby risking financial stability at the most important time. CCPs contribute financial resources to potential exposures driven by the default of a clearing member as well as losses that may arise unrelated to the clearing service (i.e. non-

default loss scenarios). Creating policies where equity adjustment could be readily available creates potential disincentives for market participants to actively participate in the CCP's recovery and thus, would likely undermine financial stability. Where there is contemplation to expose the equity of a CCP following (or worse, prior to) full and complete application of the default management and recovery measures detailed within the CCP rulebook and non-equity adjusting tools have been exhausted, it must consider the impact to the NCWOL safeguard in a manner that respects the insolvency claims hierarchy (but does not disincentivize or interfere with the provision of credit or liquidity to the CCP). To that point, CCP12 feels strongly that rulebooks have been designed and are consistent with the NCWOL safeguard.

Therefore, in light of the previous points, if guidance on this matter is still deemed necessary it is suggested to produce high-level concepts for resolution authorities to be considered for each jurisdiction to implement based on their interactions with CCPs in their local markets. Ultimately, CCPs support a robust individual and structured dialogue with their respective regulators and hope this effort continues that exercise for the benefit of global market stability.

The following pages detail our response to the individual questions outlined in Part I and Part II of the consultation.

Part I: Financial resources for CCP resolution general comments and specific question responses
- General Comments

In respect to Part I (“Financial resources for CCP resolution”), CCP12 believes additional high-level guidance could be helpful in informing how a CCP’s local resolution authority may engage in the process of resolution planning. Providing a conceptual framework for resolution authorities could foster regulatory transparency and market consistencies, while facilitating the adoption of best practices. The end result could allow local authorities and CCPs to engage in a rational and uniform discussion on how the application of financial resources could function in a CCP resolution based on standards established ex-ante, thus supporting market stability.

As it relates to the substance of the five-step process within Part I of this discussion paper, CCP12 believes that generally a process setting high-level markers for a robust discussion between a CCP and its respective resolution authority could potentially add value to the work that has already been done on resolution planning to date. There are several comments which CCP12 hopes the FSB will consider when establishing any further guidance. CCP12 believes the main intent and purpose of creating such a process should be to support a framework that allows local resolution authorities to prepare their knowledge base when establishing a resolution framework for CCPs including, among other considerations, adequacy of their local CCPs’ financial resources to support resolution based on their specific regulatory framework and unique characteristics of a given CCP. Noting that, CCP12 is hopeful that any process should take into consideration (i) whether or not the resolution authority needs to conduct independent financial assessments instead of relying on CCP readily available internal data, (ii) that the tools defined in the CCP rulebook and recovery plan have the opportunity to be utilized and generally, prior to a resolution authority intervening, as such tools are designed to support the right incentives for market participants and address stress events in a risk prudent and efficient manner, and (iii) that any approach not be unduly prescriptive upon CCP operations as any process would likely need to be adapted to local jurisdiction circumstances and CCP ownership structures. Moreover, any guidance should focus upon the resolution authorities themselves such as legal authority, resolution enactment considerations, enforcement ability, and other considerations instead of re-assessing CCP operations.

In summation, CCP12 supports an agreed framework that benefits the CCPs, regulators and the market at large. Any additional guidance issue by the FSB should focus on setting high-level principles for a robust dialogue to occur at each individual jurisdictional level without including overly prescriptive measures and should not be used as a tool to relitigate the tools and resources that have already been put in place by a CCP, in conjunction with its primary regulator, for managing default and non-default loss scenarios.

Specific Question Responses

Question 1: Do you agree with the suggested five-step process to evaluate the financial resources and tools for resolution? What other elements, if any, should be considered?

Generally, there should be an understanding between the CCP and the local resolution authority focusing on the financial resources available during resolution. As a general remark, CCP12 thinks it is important to consider how much work has been done since the global financial crisis of 2008 to enhance the resiliency of the financial system and in effect, to avoid the resolution of a CCP. Most CCPs have increased the efficacy and efficiency of their risk management tools and resources. As it relates to the specifics of the five-step process, CCP12 does have some thoughts that FSB should consider if they establish any further guidance.

For Step 2, it may be interpreted that this step could re-open analysis and appropriateness of CCP's existing recovery tools and rulebook instead of the more appropriate activity of inventorying CCP's current financial tools and operations. This interpretation should be clearly and explicitly discouraged as this could divert attention away from the main purpose and intent of developing a high-level process for CCPs and resolution authorities to assess current financial resources available for resolution. To avoid this, CCP12 believes that it would be helpful to assume (i) the continued existence and opportunity for the application, by the CCPs, of CCPs' current recovery tools and resources as defined in the rulebook and (ii) that such tools are legally enforceable. Assuming the aforementioned points, the resolution authorities and CCPs could engage in the more important exercise at hand of assessing current financial tools for resolution.

For Step 3, it may be considered to focus on only key scenarios that may potentially lead to resolution as that is most practical. It is more likely the case that multiple events of defaults by clearing members could cause the resolution of a CCP, more than any other scenario. Additionally, the likelihood of certain scenarios triggering a given CCP's resolution is dependent on how the CCP rulebook and recovery plan treat the associated risks and loss events characterizing the scenario (i.e. certain risks may trigger a loss event for one CCP), but not another. Therefore, it is important that any further guidance recognize this, whether it be with respect to the guidance currently laid out in Step 3 or Step 1 of the discussion paper.

Question 2: The discussion paper outlines a number of CCP and product specific factors that authorities should consider when assessing the adequacy of resources and tools in resolution. Are these factors appropriate or are there other factors that should be considered?

The listed factors are appropriate, but CCP12 believes that others should be considered as well. These should include, among other considerations: CCPs operating in more than one jurisdiction, legal considerations in contract law and netting, insolvency rights, authority resources and how those could impact cost, porting ability, and specific market conditions.

Regarding products involving physical settlement, where typically those products have shorter settlement cycles (i.e. T+2) and involve the exchange of a financial instrument against cash, CCP12 supports FSB's recommendations to consider those specificities when addressing adequacy of resources and tools in

resolution. Moreover, different CCPs have different products and as such any guidance should recognize that when providing relevant factors to consider.

Question 3: Should the assessment of financial resources for CCP resolution take into account (a) different CCP ownership structures; (b) different CCP organisational structures; or (c) the products cleared by the CCP? If so, how?

In all three cases it is important to keep in mind that the exercise being conducted by assessing financial resources is primarily a task in inventorying a CCP's current tools and resources. CCP12 hopes that this discussion paper nor any subsequent guidance does not veer in the direction of prescriptive changes to ongoing CCP operations. CCP12 believes that this is not, nor should it be, the intent of this exercise. Furthermore, it is apparent that these inherent differences of CCPs would affect the operation and resolution of a given CCP significantly and that is another reason why any future policy should be flexible and high level in nature.

(a) Yes, CCPs are designed to be stand-alone units but variances in ownership structures may exist, including by jurisdiction. Due to the variances and vastly different ownership structures intricacies that exist, a unique dialogue in each jurisdiction is required and should be considered in assessing the financial resources for resolution. It is important to keep in mind that where CCPs are operating within multiple jurisdictions, ultimately the CCP's home jurisdiction must be responsible for any resolution of a CCP.

(b) Yes, for CCPs that have multiple segregated risk silos, the financial resources of each silo need to be assessed independently. Additionally, an assessment of the financial resources of the overall CCP entity should be available. Other different organisational measures/resources may exist to mitigate exposure between silos and the overall entity. Additionally, it is important to understand the risk silos in the context of the market structures, laws, and regulations applicable to a CCP in its home jurisdiction.

(c) Yes, the products cleared by the CCP impact detailed strategies and risk profiles and therefore, must be taken in account in assessing the financial resources for resolution. The unique characteristics of products cleared by a CCP would have already been taken into account in each respective CCP rulebook. The products may also have impact on the default loss scenarios present within a particular CCP.

Question 4: Step 1: The discussion paper outlines a number of high-level default and nondefault loss scenarios that might lead to resolution. Does this cover a sufficiently broad range of scenarios? What other relevant scenarios, if any, should authorities consider in resolution planning?

One needs to recognize that the CCP rulebooks are designed so that default and nondefault loss scenarios should not result in resolution. Recovery is designed in a manner that supports the resiliency of the CCP and brings the CCP to a matched book without compromising financial stability. Although there is value for local CCPs and local resolution authorities to discuss their specific markets and likely potentially impactful scenarios, CCP12 believes any future policy paper is not the proper place to narrowly

define and analyze an exhaustive list of scenarios. This would lead to prescriptive measures when what is needed is a tailored jurisdictional conversation highlighting the largest risk scenarios inherent in that specific market. Further, where the resolution authority is not the CCP's supervisory authority, the resolution authority's decisions concerning a CCP's resolution should be made in consultation with the CCP's supervisor(s). It is equally important that this not be used as a mechanism to substitute the resolution authority's views for that of the supervisory authority with respect to decisions or determinations necessary to assess a CCP's compliance with the relevant regulatory framework.

Default loss scenarios: Largely, the most relevant is (iii) and the cause of potential default losses. CCP12 believes it should be noted that clearing members are contractually committed to meet their predefined obligations under CCPs rules and arrangements and that CCPs have designed such rules and arrangements to create incentives for market participants to satisfy their obligations. Further, clearing members' supervisory authorities would have to ensure that they fulfil these obligations in the case of both recovery and resolution.

Nondefault loss scenarios: Due to the nature of these risks, resolution authorities need to address them on a case by case basis and, most importantly, in the context of a given CCP and its particular ownership structures, rulebook and operations. Therefore, each resolution authority will need to work with each CCP individually to identify the appropriate non-default loss scenarios that could lead to resolution. Lastly, it is important to ensure that the resolution plans take into account the specific contractual arrangements for allocating nondefault losses to participants as the associated loss allocation mechanisms should reflect the respective responsibility structure already set in place and transparent in the CCP rulebook.

As it relates to (iv) in each section, it must be reiterated how the CCP rulebooks should be used properly in recovery and resolution. While we echo FSB's views on the need to act to preserve financial stability, CCP12 believes the prospect of authorities intervening prior to a CCP having the opportunity to apply the tools and resources defined for recovery in its rulebook and recovery plan (i.e., early intervention) could disincentivize market participants from actively participating in the default management and recovery process. Further, the prospect of early intervention by an authority creates uncertainty as to how the CCP's rulebook will operate, which is particularly concerning at a time when certainty is sought after. Ultimately, these outcomes could undermine financial stability by preemptively pushing the CCP into resolution. CCP12 firmly believes that there needs to be great caution in issuing further guidance that supports undue early intervention and resolution authorities should only step in after the CCP has had the opportunity to exhaust its tools and resources defined under its rulebook and recovery plan.

Question 5: Step 2: Are the considerations for conducting an evaluation of existing tools and resources appropriate and comprehensive? If not, what other considerations should be included?

Generally, tools which should be evaluated are those consistent with the CCP rulebook, including the default waterfall and recovery plan. This should be an exercise of inventorying a CCP's current tools and resources and not one that attempts to prescribe new or amend current ones. CCPs have carefully calibrated their current tools and resources and any assessment related to their potential resolution should not reopen these conversations. Existing tools vary by CCP and there may be more or less tools available depending on the CCP and surrounding circumstance, so therefore only general considerations

should be outlined for their evaluation. Below are additional considerations which CCP12 believes are important to keep in mind during this evaluation process:

- It is encouraging to see that skin-in-the-game (“SITG”) (and the replenishment of SITG where relevant) is mentioned as a key existing tool which is consistent with CCP rulebooks. CCP12 hopes that when discussion occurs around equity usage it should be kept at the forefront that CCPs already have a significant amount of financial resources at stake and those are predominantly used in the early stages of the default waterfall.
- It is also right that the FSB mentions the legal considerations along with NCWOL as a major factor when considering usage of equity. CCP rulebooks have already been designed so that equity usage is transparent and consistent with NCWOL safeguard, any adjustment beyond this may give rise to legal claims dependent on the jurisdiction.
- Potential capital raises by a parent should only be done voluntarily and not mandatorily. There are significant incentives for the parent company to engage in this activity to keep the business operational. That being said, there are serious legal considerations related to imposing a mandate for a parent capital injection and also operational considerations of potentially negatively bleeding of risk into other critical lines that are systemically important businesses in the marketplace (e.g. exchanges, CSDs, and other operations owned by the corporate group).
- In regard to statutory powers of the resolution authority, it is agreed that the resolution authority should have the requisite legal powers and enforcement provisions to effectively undertake resolution. The powers should be sufficiently broad and focus on actions that would be available after the tools and resources defined in the CCP rulebook and recovery plan have the opportunity to be exhausted by CCP prior to the resolution authority stepping in. CCP12 suggests the powers to be utilized in this order: non-equity adjustment provisions which are readily available, equity adjustment provisions consistent with NCWOL, and finally worst-case scenarios such as bridging, liquidation, et cetera. Any write down or bail-in of equity or unsecured debt should be done in a manner that respects the insolvency claims hierarchy in the local jurisdiction without disincentivizing or interfering with the provision of credit or liquidity to the CCP. CCP12 believes this to be the best approach from a high-level view and that any future policy does not need to go further; what is needed is with more discussion to be undertaken in each local jurisdiction.

Question 6: Step 3: Are the considerations for analysing the hypothetical resolution costs (covering total losses and operational costs) appropriate?

CCP12 recommends that an assessment focus on major and common default and nondefault scenarios that are relevant to the CCP being assessed. The scenarios should be chosen based on the likelihood of them occurring and level of risk posed to the specific CCP. Please also refer to CCP12’s comments with respect to Question 4.

An activity of exhaustively analyzing resolution costs for an extensive list of scenarios is both inefficient and impractical. Another important consideration may be how an authority may impact costs due to their own internal operation and how it interacts with the CCP during the resolution process. Resolution

operation must be designed efficiently to reduce unnecessary additional costs, and this is something that should be added in any future policy guidance. Lastly, when analyzing resolution costs it should be assumed that recovery has been fully utilized as per the CCP rulebook and recovery plan and only after this has taken place should the resolution authority step in. Intervention any earlier is not appropriate as it does not allow sufficient opportunity for the CCP to bring the market back to stability in a manner that is consistent with efficiently designed incentives and transparency.

Question 7: Step 4: Is there merit in relevant authorities and CMGs conducting quantitative analyses for the purpose of identifying and sizing potential additional tools or resources for resolution purposes? If so, what quantitative analysis should relevant authorities and CMGs conduct and how could they obtain the necessary data?

There is merit for the relevant authorities to have information about sizing potential tools for resolution. CCP12 suggests that resolution authorities leverage the information and data already present within and created by the CCP itself and if something is not available, the CCP can work with the relevant authority to provide such information. We do not suggest that an authority conduct a de novo analysis of information that is already presently available. For example, for default losses one can use data from the CCP on size and positions to calculate potential resolution costs, with the focus being on calculations CCPs have already conducted (i.e. “cover” scenarios). Additionally, authorities should consider whether pertinent information on scenarios and their impact on members and indirect participants can be best obtained from the market participants themselves. For instance, the costs and impact of a CCP general tear-up and wind-down on participants could be investigated. It is recognized that the costs of nondefault losses are more challenging to calculate due to the nature of the loss, so it is best for an authority and CCP to work together to quantify these costs based on a constructive dialogue.

Question 8: Step 5: Are the considerations regarding potential means to address funding gaps (including of any proposals to reserve resources for use in resolution) appropriate? Do they adequately address the issues of availability, costs and benefits, impact on and interaction with recovery and business as usual? If not, how should they be framed?

The CCP and its rulebook are designed to not have any such gaps. This is in collaboration with local authorities, and as such in the discussions surrounding resolution it must be made clear from a policy perspective that the CCP rulebook should be followed unless proven materially inadequate.

In the extreme unlikely event that there has been a calculation of potential substantial funding gaps during an assessment, resolution authorities should undergo a discussion with CCPs to determine the best course of action based on that specific local jurisdiction. CCP12 believes it is not appropriate to enact any high-level policy that includes specific tool considerations for resolution authorities as this may be seen as an opportunity to attempt to relitigate agreed upon tools and resources currently available in a given CCP which is not the intent of this policy consideration; the policy consideration being to understand the application of current tools and financial resources under the CCP rulebook in order to best prepare for resolution.

Part II: Treatment of CCP equity in resolution specific question responses - General Comments

In regard to Part II (“Treatment of CCP equity in resolution”), CCP12 believes that current rulebook designs have been drafted and are consistent with previous guidance provided by CPMI-IOSCO and other standard setting bodies. In particular, as the consultation itself highlights, the issue of equity treatment has been defined by the FSB in its Key Attributes and elaborated on in the FMI Annex and the corresponding CPMI/IOSCO recovery report. The consultation rightly explains that these principles are established, and that should there be particular cases identified by competent authorities, they as well as policy makers should rectify these. The rulebooks have taken into account the usage of equity already and have designed such usage consistent with (i) regulatory guidance, (ii) stakeholder engagement, (iii) key considerations of transparency, and (iv) the NCWOL safeguard. As such, to suggest that the use of CCP equity could be available in the resolution process outside of how it is currently treated in a CCP’s rulebook is concerning. Further, CCP12 believes that use of CCP equity beyond the rulebook would likely appropriately give rise to NCWOL claims. The discussion of this topic should also be based on the specifics of the event causing the resolution and the specific local jurisdictional elements that do not make it fit for prescriptive policy to be made at such a high-level.

It should be noted that CCPs already commit appropriate amounts of financial resources for addressing scenarios under market stress events that are consistent with regulatory guidance established by CPMI-IOSCO as well as local regulatory requirements. The amount of a CCP’s financial resources that may be used, and the timing of their use, is defined in a CCP’s rulebook and designed to incentivize the continuity and recovery of the distressed market while supporting the stability of the broader financial system. CCP12 strongly believes that a CCP’s rulebook should be adhered to during resolution unless proven materially inadequate at handling such market stress and that generally, the tools and resources defined in the rulebook should be applied prior to the resolution authority stepping in; and in any such cases, the resolution authority should be compelled to document reasons thereto in an evidence-based manner. Any deviation from an efficient and well-planned rulebook could have grave impacts on the incentives of a CCP’s market participants to actively participate in the default management, recovery, and resolution processes.

Current rulebook designs have a host of tools afforded to it which are more suitable and, possibly more importantly, readily available during a time sensitive situation than the ability to adjust equity during resolution. Moreover, de-capitalizing a CCP at a time of extreme market distress would significantly impair, if not undermine, attempts to restore market stability.

- Firstly, putting a CCP in a less capital solvent position limits flexibility by limiting operational funding capacity;
- Secondly, there are important de minimis capital standards that need to be strictly followed; and
- Thirdly and most critical, adjusting previous incentives would likely misalign predetermined standards that could contribute to the inverse of market stability.

On the other hand, adjusting for equity increases by way of a new share grants or debt-to-equity bail-ins provide other unique challenges. These are time-consuming processes that are not appropriate in the midst of a time sensitive situation. Furthermore, participants may be prohibited by law from becoming shareholders within of a CCP and, even if this were permissible, it may cause situations in which participants are incentivized toward resolution which is contrary to public policy considerations for market

stability of a fully capacitated CCP. This all being said, the NCWOL safeguard should be followed and CCP12 is encouraged by the FSB recognizing this matter.³ This interaction between NCWOL and equity adjustments is largely dependent on local jurisdictional insolvency laws and individual CCP creditor circumstances (including an assessment of different ownership, organizational and equity structures, such as where a CCP has multiple segregated silos with each supported by the designated part of its equity), market structure (including consideration of critical clearing services), and therefore do not lend themselves to a more prescriptive treatment in any future standard setting policy document.

Lastly, there seems to be discussion around making comparisons between resolution and the treatment of banks and how those lessons from bank resolution can be brought over to CCPs. CCP12 does not believe this is appropriate. CCPs are not banks, having distinct functions and market purpose as banks themselves are risk takers and CCPs are risk managers.⁴ To treat the lessons learned from resolution of banks as applicable to CCPs is not appropriate. We hope that this can be understood when and if future policy is generated on this matter.

³ <http://www.fsb.org/wp-content/uploads/P050717-1.pdf>

⁴ <https://www.chicagofed.org/~media/publications/policy-discussion-papers/2017/pdp-2017-01-pdf.pdf>

Specific Question Responses

Question 9: Do you agree that the key issues to CCP equity bearing loss in resolution have been accurately identified? Are there other key issues regarding equity bearing loss? What are they and how should they be addressed?

CCP12 agrees with the view from the FSB that NCWOL needs to be supported in relation to equity treatment as it is a fundamental safeguard set within the Key Attributes. CCPs are already incentivized in recovery and resolution through SITG, further CCP contributions as agreed in the existing rulebook and/or recovery and resolution plan, and the risk of reputational harm. CCP12 is encouraged by the FSB highlighting the significant equity and financial resources that CCPs maintain today. These financial resources, and any equity that need to bear losses are enshrined in the CCP rulebook. To deviate from this transparent, contractually agreed, efficient, and a robust framework should not be done unless in extreme resolution circumstances when a rulebook is proven materially inadequate. CCPs can think of no reason why equity must be immediately used once resolution occurs. In fact, by stating that equity must be used during resolution prior to any other tools is a point that CCP12 does not agree with and does not seem rational nor practical. Authorities should consider: at what point is the system put in resolution; what tools have yet to be used; what type of default it is; what are the current incentive structures and many other factors. Therefore, blanket specific prescriptions set by ex-ante policy for a situation that needs case-by-case diagnosis is not suggested.

Any use of equity as one of the first tools during resolution can skew incentives for market participants to participate in the default management and recovery process. Certain methods of increasing equity are also problematic. For example, debt-to-equity bail-ins would create misaligned incentives and are likely impermissible under certain legal contractual and/or statutory frameworks. Generally, any mechanism for use of CCP equity should fulfill three main objectives: (i) the preservation of the right incentives pre-resolution; (ii) the support for continuity and (iii) the preservation of the CCP's independence post-resolution. As such, we believe any conversations on the use of CCP equity should be based on the circumstances of the nature of the default, unique characteristics of a CCP and the related market, and local insolvency laws. CCP rulebooks have taken this into account being designed to be consistent with the NCWOL safeguard. CCP12 fully supports a jurisdictional discussion on this matter as keeping the CCP's critical services operational is the objective to support financial stability.

Question 10: Should the treatment of CCP equity in resolution take into account different ownership structures? If so, how?

Yes, as different CCP ownership structures may lend themselves to different levels of situational complexities that are not universally applicable to the CCP community. Noting such, resolution authorities should consider the impact of CCP and its ownership structures as it relates to but is not limited to:

- Potential impact on other clearing services, and other critical services if performed within same legal/corporate entity/group (or parent);

- Where the legal entity and/or parent entity may voluntarily provide additional financial resources;
- Individually unique corporate laws in each jurisdiction; and
- The nature of the owners themselves (e.g. public or private).

Question 11: What are your views on the possible mechanisms for adjusting the exposure of CCP equity in bearing loss in resolution set out in Section A? What other possible mechanisms, if any, should be explored?

CCP12 strongly believes that the most logical, practical, and safest approach to manage a stress event at a CCP would be to follow the CCP rulebook and default waterfall and generally, the resolution authority should not step-in until after the tools and resources in the CCP rulebook and recovery plan have been exhausted. If other tools not prescribed within the CCP rulebook are deemed to be invoked, it is suggested to use tools that are readily available and that do not give rise to NCWOL. Furthermore, imposing default losses onto shareholders would have tremendous impact on the CCP structure and would increase systemic risk of a CCP. In a group setting, losses in one clearing service could affect CCP capital and consequentially other services of the same CCP. CCP12 also strongly disagrees with the principle of compensating clearing members for tools utilized as a part of CCP recovery and resolution, particularly with the CCP's equity as it reduces the likelihood of a successful recovery by skewing participants incentives to actively participate in recovery. In turn, this reduces the likelihood of a successful sale of the CCP in resolution, threatens CCP's independence post-resolution, creates sovereignty issues when potential shareholders are not established in the same jurisdiction, and may not be legally tenable.

In relation to the specific points within Section A:

- (i) The CCP rulebook, including default waterfall is designed in such a way based off of previous standard setting bodies guidance and such rulebook represent an agreed upon contract between a CCP and its members. CCP12 suggests this is not altered, as it is the bedrock of recovery and resolution strategies and altering the arrangements defined under a CCP rulebook create uncertainty as to how the CCP rulebook will be applied, which is of utmost importance in managing a stress event. Additionally, the opportunity to modify a CCP's loss allocation arrangements is likely to reopen discussions on CCP practices that have already occurred and been agreed upon, as noted above. Further, excessive CCP equity usage would appropriately give rise to NCWOL claims.
- (ii) We disagree, as already mentioned for various reasons stated throughout the response.
- (iii) We potentially agree but as a worst-case scenario.
- (iv) We potentially agree to new shares for new money. For reasons already stated in this response, CCP12 believes debt-to-equity conversion not to be a suitable tool for resolution; this would likely raise NCWOL claims as well.

Question 12: Section B outlines different options for the point in time or in the waterfall for imposing losses on equity. What are your views on these options? Are there any other possible options?

We suggest not being prescriptive on this matter as it largely depends on the totality of the circumstances and in particular, the CCP rulebook's treatment of the potential losses. The CCP rulebook should be followed and any treatment of equity should be in accordance with the CCP rulebook so long as the CCP rulebook has not proven to be materially inadequate. However, if equity should be adjusted at all, it need be after the CCP rulebook and non-equity adjustment tools are exhausted and then only consistent with the NCWOL safeguard.

As outlined above, another factor to consider is the ability of the resolution authorities to implement resolution if that power is too easily invoked. To that point, it is suggested that there be a clear demarcation between recovery and resolution with all available steps in recovery as set out in a CCP rulebook occurring prior to any consideration of the resolution authority stepping in.

Question 13: What are your views on the potential constraints and challenges described in Section C? Are there other challenges or constraints to equity bearing loss? What are they and how should they be addressed?

CCP12 agrees completely with the discussion paper's characterizations of the assumed NCWOL safeguard under (i). This is precisely why balance is needed and prescriptive rules that start with depleting CCP equity are inappropriate. Equity usage by a CCP is defined by the rulebook and as previously stated by allowing the CCP to follow its rulebook fully, assuming it is not proven materially inadequate, equity may be used in accordance with such rulebook consistent with NCWOL safeguard. However, if the resolution authority decides to place the CCP into resolution and then immediately adjusts equity there are likely to be NCWOL claims depending on specific jurisdictional insolvency laws and such claims are warranted because the resolution authority has taken steps to act inconsistently with the CCP rulebook, which could have grave consequences on the incentives of market participants to actively participate in the default management and recovery process.

Other constraints would include undesired outcomes. Depleting equity will increase risk of internal contagion within the CCP and would go against policy goals of keeping a CCP's critical operations solvent and operational for as long as possible. Moreover, exposing equity to bearing losses in resolution could have significant consequences to the structure of the CCP post-resolution and even make it questionable whether a CCP could exit resolution into non-resolution operation once again; the ultimate best-case scenario for the market.

All these factors can be addressed, and in many cases have been, by having a robust dialogue between a CCP and its local authority as noted above, CCPs have carefully designed their rulebooks for managing a stress event and this should not be discounted. As stated previously, a one-size-fits all approach is inappropriate as the constraints are legal and situationally dependent.

Question 14: Section D outlines a number of policy considerations for the treatment of CCP equity in resolution. Are they appropriate and comprehensive? Would you suggest any additional policy considerations?

CCP12 agrees with the appropriateness of some of the policy considerations. In particular, we firmly believe that recovery/resolution already incentivizes CCPs to be fully engaged in doing what is needed to keep operating the business soundly and in the most efficient manner. The cornerstone of these incentives already includes putting CCP financial resources at stake in the form of SITG, or other features appropriate to the particular market and jurisdiction. It is encouraging to see that the FSB acknowledges that the CCP already contributes an appropriate portion of equity in the most efficient manner and this point should be factored in any future policy guidance. As such we echo the remarks in the discussion paper that, "SITG is not calibrated with a view to constituting a significant amount of loss absorbing resources. Rather, SITG is calibrated to provide confidence in the risk management incentives of the CCP," which is consistent with CCP12's view that CCPs are inherently incentivized to employ prudent risk management standards, with or without SITG.

Further, CCP12 does not think equity usage beyond the rulebook is appropriate in resolution. If however the resolution authority sees fit, it should be subject to first exhausting the CCP rulebook and the non-equity adjustment tools. If equity adjustment then occurs it needs to be consistent with the NCWOL safeguard.

Lastly, as the discussion paper notes many CCPs may be part of a larger corporate group that offers other key services and therefore it does not make sense to prejudice the operations and ownership structures which may and likely have other critical market infrastructure within it. Therefore, CCP12 repeats again that prescriptive rules are not appropriate related to treatment of equity.

Question 15: Does the treatment of CCP equity in resolution appear clear under existing arrangements in your jurisdiction or in relation to CCPs you are familiar with?

CCP12 does not have any substantive comment from the perspective of a global association. That being said, it is important to recognize that any policy created by standard-setting bodies should allow for flexibility for this to be a jurisdictional exercise as the matter is too situationally and legally dependent. This would take the form of the local regulators and local CCPs engaging in a robust dialogue for the benefit of all market participants.

Question 16: How could authorities reconcile the expectations that equity bears loss in resolution with the 'no creditor worse off than liquidation' safeguard?

The NCWOL safeguard is a crucial feature of a well-functioning CCP resolution regime. The safeguard assumes, at a minimum, the full application of the CCP's rules and arrangements. The safeguard for default losses should consider the principle of "value of continuity" and should take into account the CCP's default waterfall, the CCP's recovery tools, and the losses and costs of closing the CCP.

Value/costs of continuity must be transparent to prevent clearing members from claiming any loss imposed on equity in resolution before loss allocation and position allocation tools available under recovery are exhausted.

Lastly, the NCWOL safeguard and equity usage are not inconsistent, as the treatment of CCP equity is already addressed in the CCP rulebook. As we noted above, while we disagree with CCP equity used in such manner it must occur in a manner consistent with local insolvency laws and a CCP's unique creditor profile and importantly, should give rise to NCWOL claims for the CCP.

This approach:

- Allows for legal certainty for the resolution authority to focus on employing the relevant resolution tools;
- Maintains the incentives for all parties to engage in resolution;
- Provides transparency and clarity for all stakeholders; and
- Provides International consistency.

Question 17: What, if anything, should change with respect to the treatment of CCP equity in resolution either to clarify existing arrangements or to potentially adjust the exposure of equity bearing loss in resolution (for example, setting out any additional measures to have equity bear loss in resolution in CCP rulebooks)?

CCP12 believes that rulebooks are clear on this matter. Any additional matters related to treatment of equity should be discussed between the local regulator and the local CCP.

CCP12 greatly appreciates the opportunity to comment on this discussion paper. CCP12 is highly interested to discuss these further and to elaborate on any of the comments described in our response. For further information, please send an email to office@ccp12global.com.

Sincerely,



XU Zhen,
Chairman of CCP12



Marcus Zickwolff,
CEO of CCP12