



Carl B. Wilkerson
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Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: Essential Aspects of CCP Resolution Planning

Dear Sirs and Madams:

The American Council of Life Insurers (ACLI) is a national trade association with 280 member companies that represent 95 percent of industry assets, 92 percent of life insurance premiums, and 97 percent of annuity considerations in the United States. Our members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance that 75 million American families rely on for financial and retirement security. We respectfully offer our comments on your Discussion Note, *Essential Aspects of CCP Resolution Planning*¹.

Life Insurers have actively participated in the dialogue concerning the regulation of domestic and international derivatives markets, and have provided constructive input on proposed rulemaking implementing Title VII and Section 619 of the Dodd Frank Wall Street Reform and Consumer Protection Act (the “Dodd Frank Act”), and in parallel initiatives developed by global standard setters.² We greatly appreciate the opportunity to offer our commentary on the Financial Stability Board’s Discussion Note.

¹ <http://www.fsb.org/wp-content/uploads/Essential-Aspects-of-CCP-Resolution-Planning.pdf> [last visited on, October 10, 2016].

² For example, ACLI submitted detailed comments on the following parallel regulatory proposals developed by the Prudential Regulators, the U.S. Commodity Futures Trading Commission (“CFTC”), and the U.S. Securities and Exchange Commission (“SEC”):

- Supplemental Request for Comments on Proposed Margin and Capital Requirements for Covered Swap Entities; [\[http://www.fhfa.gov/webfiles/24691/95_American%20Council%20of%20Life%20Insurers%20ACLI.pdf\]](http://www.fhfa.gov/webfiles/24691/95_American%20Council%20of%20Life%20Insurers%20ACLI.pdf) [Prudential Regulators];
- Supplemental Request for Comments on Proposed Margin Requirements Governing Uncleared Swap Transactions for Swap Dealers and Major Swap Participants [\[http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58806&SearchText=wilkerson\]](http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58806&SearchText=wilkerson) [CFTC]; [last visited on October 10, 2016].
- CFTC Proposal on Protection of Cleared Swaps Customer Contracts and Collateral [\[http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48045&SearchText=wilkerson\]](http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48045&SearchText=wilkerson) [CFTC]; [last visited on October 10, 2016].and,

Overview of FSB Discussion Note

On August 16, 2016, the Financial Stability Board (FSB) published a Discussion Note on [*Essential Aspects of CCP Resolution Planning*](#),³ eliciting input on aspects of central counterparty (CCP) resolution considered core to the design of effective resolution strategies. On August 16, 2016, the FSB also published, jointly with the Basel Committee, Committee on Payments and Infrastructures (CPMI) and International Organization of Securities Commissions (IOSCO), a [*progress report on the workplan*](#)⁴ to enhance the resilience, recovery planning and resolvability of CCPs.

The release accompanying the FSB Discussion Note indicates that “with CCPs being an increasingly important part of the financial system through their ability to mitigate and manage counterparty credit risk, particularly following post-crisis reforms to mandate central clearing of certain standardized over-the-counter derivatives, it is vital that CCPs do not themselves become a new source of too-big-to-fail risk.”

The [*FSB Key Attributes of Effective Resolution Regimes for Financial Institutions*](#)⁵ (*Key Attributes*) and implementation guidance on financial market infrastructure (FMI) resolution established a framework for FMI resolution. This framework states the objectives of FMI resolution and a range of powers and tools that should be made available to resolution authorities to resolve a failing FMI.

In explanation of the FSB Discussion Note, the accompanying release explained that while the *Key Attributes* and existing guidance describe several tools that should be available to regulatory authorities, they do not discuss how those tools could be used or combined to develop strategies for the effective resolution of CCPs. In some areas, FSB observed that further guidance may be required to assist jurisdictions with implementing effective resolution regimes and to assist resolution authorities with developing credible resolution strategies and plans.

The FSB Discussion Note covers several aspects of CCP resolution planning, including:

- Timing of entry into resolution;
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- SEC proposal on margin, capital and segregation for security-based swap dealers and major security-based swap participants [<http://www.sec.gov/comments/s7-08-12/s70812-25.pdf>]. [last visited on October 10, 2016].
 - Request for Comments on Reproposed Rule for Margin and Capital Requirements for Covered Swap Entities [http://www.federalreserve.gov/SECRS/2015/January/20150127/R-1415/R-1415_112414_129786_278794149594_1.pdf] [last visited on October 10, 2016].

ACLI also submitted comments on the initial BCBS-IOSCO Consultative Document for Non-Centrally Cleared Derivatives, published by the Basel Committee on Bank Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) (May 2012) (“BCBS-IOSCO Consultative Paper”) [<http://www.bis.org/publ/bcbs226/acoli.pdf>] [last visited on October 10, 2016], and the BCBS-IOSCO Second Consultative Document on Margin Requirements for Non-Centrally Cleared Derivatives (Feb. 2013) (“Second BCBS-IOSCO Consultative Paper”) [<http://www.bis.org/publ/bcbs242.pdf>]. [last visited on October 10, 2016].

³ <http://www.fsb.org/wp-content/uploads/Essential-Aspects-of-CCP-Resolution-Planning.pdf> [last visited on, October 10, 2016].

⁴ <http://www.fsb.org/2016/08/progress-report-on-the-ccp-workplan-2/> [last visited on, October 10, 2016].

⁵ <http://www.fsb.org/what-we-do/policy-development/effective-resolution-regimes-and-policies/key-attributes-of-effective-resolution-regimes-for-financial-institutions/> [last visited on, October 10, 2016].

- Adequacy of financial resources;
- Tools for returning to a matched book and allocating default and non-default losses;
- Application of the No Creditor Worse Off safeguard and treatment of the CCP's equity in resolution; and,
- Cross-border cooperation and effectiveness of resolution actions.

The FSB Discussion Note also has related questions on which the FSB seeks comment.

Statement of Position

ACLI represents life insurers that are deemed to be 'financial entities' for the purposes of the Dodd-Frank Act and similar laws and regulations in other jurisdictions. Consequently, life insurers are compelled to clear their derivative transactions that are subject to regulatory clearing mandates (e.g., certain interest rate swaps). Under the laws of the states (e.g., New York) that govern the regulation of U.S. life insurers, their use of derivatives is generally limited to risk management, such as hedging interest rate and equity risks arising from their life insurance and annuity products. Life insurers are not "swap dealers" or "major swap participants." It follows that the safety and soundness of CCPs is of vital importance to life insurers that expect their cleared derivatives to reduce their portfolio risks, not create new ones. We welcome the FSB's careful consideration of the safety and soundness of CCPs, including the resolution of a failing CCP.

Indeed, because life insurers are compelled to use CCPs but have no voice in their governance, life insurers and other similarly situated end-users rely upon financial regulators like the FSB to create robust "guardrails" for CCPs that protect the public and the broader financial system. We recognize that many of the issues highlighted by the Discussion Note are challenging and technical. There are, however, a few points raised by the Discussion Note that are of special interest to insurers and financial end-users who have no option but to use CCPs to clear the derivative trades that hedge life insurers' financial market risks.

1. Initial Margin Haircuts

The Discussion Note asks whether "initial margin haircutting [should] be considered as a tool for the allocation of losses in resolution?"⁶ IM should never be used to fund a failing CCP. As you know, IM is required as a "performance bond" to assure the creditworthiness of every position owner – it does not represent a gain or loss on the position it secures. As such, for life insurers IM is an asset like their other portfolio investments (e.g., sovereign debt, corporate bonds, etc.) In fact, life insurers often use U.S. Treasury securities to meet their IM obligations. Insurers have never considered their IM to be subject to CCP credit risk, nor should they.

As insurers are already compelled to clear their risk-reducing transactions through a CCP, the novel idea of also putting their IM at risk would amount to misappropriation from one already held hostage. Such a resolution tool, if employable, would likely create perverse behaviors. Faced with the prospect of losing their IM, insurers could liquidate their hedges sooner than later when faced with the prospect of a failing CCP, adding to the liquidity stresses already facing the CCP and its clearing members, while at the same time putting the insurers' portfolios at greater risk in a

⁶ See <http://www.fsb.org/wp-content/uploads/Essential-Aspects-of-CCP-Resolution-Planning.pdf> at 6 [last visited on, October 14, 2016].

stressed scenario precisely when hedges should have the most utility. Rather, IM should not be haircut but should be either available to underwrite the porting of positions to successor clearing members and clearing facilities or returned to the customer who owns it, if their positions are torn-up.

2. Suspension of the Clearing Mandate

The Discussion Note asks, “What should be the role, if any, of the suspension of the clearing mandate in CCP resolution and how should this be executed in a cross-border context?”⁷

We support the idea of suspending the clearing mandate as a “tool” in a resolution scenario. In such case, it is likely that the cleared trades have been (or will be) torn up either in part or in whole and the affected insurers would no longer be hedged. Assuming that affected life insurers would opt to replace their hedging positions, it could be useful in the stressed scenario to have a choice to do so bilaterally rather than through another CCP, assuming there is one to replace the one that has failed. Life insurers are generally strong, credit-worthy counterparties that already have in place OTC bilateral documentation with multiple swap dealers that are willing to take on their credit risk.

Therefore, if the choice for life insurers is to have either no hedge available because of the combination of the clearing mandate and the absence of an available CCP to clear trades, on the one hand, versus having the option to trade bi-laterally outside the clearing mandate, on the other, the latter option is preferable.

3. Availability of Public Funds

The Discussion Note describes the possibility that “amounts borrowed from public funds” in a resolution scenario could be “recovered from the defaulter’s estate, shareholders, creditors (including CCP participants) or the financial system more widely.”⁸

We understand that the E.U. and U.K. central banks have announced publicly that they are available to provide liquidity to a failing CCP. In the U.S., on the other hand, the post-financial crisis laws erected procedural and political barriers to any public funding of CCP liquidity requirements. An approach involving the use of public funds is preferable and recognizes the critical importance of CCPs in the new paradigm created by lawmakers. Any public funds used to recover or resolve a CCP should be repaid as soon as practicable. We do not believe, however, that end-users in the clearing process, such as life insurers, should be compelled to fund liabilities that they did not create. This responsibility properly lies foremost on the CCP’s equity owners and clearing members responsible for the CCP’s governance.

⁷ See <http://www.fsb.org/wp-content/uploads/Essential-Aspects-of-CCP-Resolution-Planning.pdf> at 8 [last visited on, October 14, 2016].

⁸ See <http://www.fsb.org/wp-content/uploads/Essential-Aspects-of-CCP-Resolution-Planning.pdf> at 17 [last visited on, October 14, 2016].

Conclusion

The FSB Discussion Note poses several significant questions about CCP resolution that are very important for life insurers as end users that have no option but to use CCPs to clear the derivative trades that hedge our financial risks.

Thank you for your attention to our views. If any questions develop, please let me know.

Sincerely,

Carl B. Wilkerson

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