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Euroclear Response to the Financial Stability Board on Effective Resolution of Systemically Important Financial Institutions

This response is provided on behalf of the Euroclear group of companies ("Euroclear"). Euroclear comprises the International Central Securities Depository ("ICSD") Euroclear Bank ("EB"), based in Brussels, as well as the national central securities depositories ("CSDs") Euroclear Belgium, Euroclear France, Euroclear Nederland, Euroclear UK & Ireland Limited, Euroclear Finland, and Euroclear Sweden. (It also includes Xtrakter, a provider of trade matching and transaction reporting services based in the UK.)

Euroclear group welcomes the Financial Stability Board (FSB) initiative for a common resolution and recovery framework for SIFIs. As Financial Market Infrastructures (FMIs), we support all initiatives that will make the functioning of financial markets more secure, eliminate uncertainties and contain systemic risk.

Our response focuses specifically on the direct and indirect impact of the proposed FSB recommendations on FMIs, and CSDs specifically.

KEY POINTS

FMIs should not be treated as regular SIFIs, but should be subject to a specific resolution regime

1. Market infrastructures such as payment systems, CCPs, CSDs and Securities Settlement Systems (SSSs)[1] play a crucial and specialised role in financial markets. The functions of market infrastructures (some of which have a banking licence) must be preserved - even if they suffer important losses - in order to prevent considerable systemic contagion. For FMIs, a simple market exit through liquidation can generally not be considered a credible option. The CSDs' specific role is recognised by the existing CPSS/IOSCO recommendations for Securities Settlement Systems, the upcoming CPSS/IOSCO Principles for FMIs and the future proposed European Union CSD legislation.
2. CSDs operate under an extremely (*ex ante*) low risk profile, often taking no counterparty or liquidity risk. They do not take retail cash deposits. The rules and standards with which they comply ensure that the possibility of default is as remote as possible. This makes the balance of *ex ante* and *ex post* measures for CSDs totally different from a regular profit-maximising SIFI, and greatly reduces the need for an *(ex post)* resolution regime.

[1] In the remainder of the response, we use the generic term CSD to include CSD, ICSD and (operator of) SSS.

3. We note that the common characteristic of the companies under the SIFI category is that their potential failure would have an important impact on the stability of the market. However, we believe that any adequate resolution framework should not be based on such post factum similarity, but, first of all, on similarities in their role, risk profile and regulatory environment.
4. Therefore, and although national authorities in some countries have classified their national CSD as a SIFI for their local market, we believe that market infrastructures (and particularly CSDs) should be excluded from the current FSB proposals and covered by a bespoke regime under the guidance of CPSS/IOSCO (which has already started work in this area). Indeed we believe that some of the measures proposed by FSB, if applied to CSDs, could conversely have a detrimental effect on market stability.

Adequate safeguards should be installed to prevent negative impact of a SIFI resolution on all FMIs

5. We particularly welcome the FSB's intention to ensure a number of safeguards related to a temporary stay on early termination rights. We note, however, that, while the FSB explicitly mentions CCPs, there is no mention of other types of essential systems such as payment systems and CSDs. We believe that appropriate safeguards should also be established in respect of securities settlement systems operated by CSDs (e.g. regarding temporary stay provisions).
6. CSDs should be protected against the potential negative impact of the use of resolution tools for one of their SIFI participants (e.g. respecting the specific protections resulting from the EU Settlement Finality Directive). Such impact may require further analysis by appropriate authorities.

ANSWERS TO THE QUESTIONS

Questions 1 and 2 – Scope

Because of their unique and systemic role, CSDs have long been subject to intense regulation and oversight. These supervisory and oversight regimes have developed a strong *ex ante* defence against the failure of a CSD. For instance, such infrastructures often avoid counterparty risk and, where they are permitted by their regulators to take credit risk, such risk is only related to settlement and custody activity and is extremely short-term and collateralised. They also use much more conservative capital requirements than other banks. Such *ex ante* measures are even further enhanced by the proposed Principles for Financial Market Infrastructures of CPSS/IOSCO.

We therefore believe that some of the suggested resolution tools may not be appropriate for CSDs. For example, as a participant of a CSD generally cannot use another institution for CSD services in case of a crisis, liquidation of a CSD does not seem to be an appropriate solution. As an alternative to liquidation, the consultation document suggests the options of sale of business (possibly through a bridge bank) or creditor-financed recapitalisation. We believe that the authorities should give further thought on whether these remedies are appropriate for the particular role of CSDs. Any recapitalisation by creditors (rather than just existing shareholders) would greatly alter the ownership and control of such infrastructure which might have long term consequences e.g. on the infrastructures' risk profile.

Other tools (e.g. allowing for urgent mandatory re-capitalisation by existing shareholders) - which are not part of the suggested FSB current framework - could

be more appropriate to ensure recovery of an CSD, but which would not be appropriate for other SIFIs. We would appreciate exploring such other tools with appropriate bodies.

Overall, we believe it will be difficult to ensure a coherent resolution framework for FMIs if they are made subject to rules intended for regular SIFIs, adapted on a rule-by-rule basis to cater for the specificities of market infrastructures. Consequently, we believe that the authorities should explicitly exclude FMIs (and more specifically CSDs) from the framework suggested for regular SIFIs. CPSS-IOSCO seems well placed to create an appropriate resolution framework for systemically important FMIs which might utilise different tools than those foreseen for a regular SIFI.

We would also suggest that resolution authorities are given a certain degree of flexibility to use those elements of the resolution regime they deem appropriate for an FMI. Those elements should be agreed upon as part of the entity-specific Resolution and Recovery Plans. It is however important that, while seeking such flexibility, the level playing field of CSDs be preserved. This will require information sharing and coordination between relevant regulatory authorities.

Questions 3 to 8 – Bail-in powers

With regard to bail-ins and their impact on CSDs, we believe that authorities need to specifically consider:

(i) if the bail-in within resolution tool is appropriate to re-capitalise a CSD, in comparison with other tools.

(ii) how to use the bail in within resolution tool in respect of a CSD participant or a CSD service provider. FMIs should be protected against the potential negative impact of the tools used to re-capitalise one of their SIFI participants or service providers.

For instance, we believe it might not be appropriate to use a bail-in for liabilities that result from (short-term) transactions related to cash and securities clearing and settlement (including repurchase transactions). Conversion of such transaction-related debt into equity would severely hamper the liquidity and efficiency of financial markets, could negatively impact the functioning of FMIs, and would have systemic consequences.

Questions 16 to 19 - Improving resolvability

As an FMI, we support the FSB requirements to FMI users suggested in the section "Global Payment Operations". We believe that they will increase safety and certainty of financial markets.

However, we would suggest to rename the section '*Global payment and securities settlement operations*' and ensure that the particularities of securities accounts and FMIs providing securities settlement services are also taken into account.

Question 26 - Stay on early termination rights

It is essential that resolution procedures do not lead to a disruption of finality arrangements, security ownership rights, or to uncertainty of collateral arrangements. The provisions of the EU Financial Collateral Directive and the Settlement Finality Directive must be preserved during the implementation of a resolution regime. Specifically, counterparties who are secured creditors should not be prevented from realising collateral to cover debts which are due and payable –

whether or not based on netted positions - under the normal operation of a collateral agreement.

Any delay in exercising collateral rights could create a liquidity risk for the counterparty and lead to an undue market risk on the collateral. In cases where the counterparty is an FMI we do not believe that such a transfer of risk would be acceptable, as it would actually increase risk contagion and threaten overall financial stability. In the interest of the overall robustness of the market infrastructure, we would, therefore, ask for an exclusion of operators of SSSs.

Question 30 – Scope of temporary stay

We welcome that FSB suggests certain safeguards related to the temporary stay on close-out netting and termination of rights (Annex I 'Key attributes of effective resolution regimes', item 4.1 xii and xiii).

Before deciding on the suspension of payment or delivery obligations, or on the suspension of rights to close-out netting, the potential for systemic disruption (as a consequence of such suspensions) should be properly assessed. If payment or delivery obligations in relation to market infrastructure services are suspended, this may put at risk both:

(i) the orderly processing of transactions within payment and securities settlement systems, and

(ii) payment and securities settlement systems themselves.

In order to ensure the orderly functioning of systems operated by FMIs such as SSS operators in the EU in case one of their clients is subject to resolution measures, any stay must be compatible with the protections granted by the EU Settlement Finality Directive. A stay should not in any circumstance lead to the voidance of netting performed by the system, nor to the revocation or voidance of any instruction which has entered into such a system and obtained an irrevocable status according to the system's rules. The systems and their participants must continue to be protected against the risk of unwind of parts or all of the settlement process.

We note that this concern is already partially covered in the safeguards listed in Item 4.1. xii of Annex I - Key attributes of effective resolution regimes. The reference to FMIs in Annex 1 must however be expanded to include payments entered into a securities settlement systems.

Finally, as explained under question 26, where an FMIs is counterparty to a financial transaction, it would be justified on the grounds of overall financial stability to exempt FMIs from the suggested stay on early termination rights.

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