

Via Electronic Mail (FSB@fsb.org)

17 February 2017

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

**RE: FSB Guidance on Continuity of Access to Financial Market Infrastructures (“FMIs”) for a Firm in Resolution**

Dear Board Members:

CCP12 is a global association of 36 major central counterparty (“CCP”) organizations in Europe, Asia and the Americas. CCP12 was formed to share information, develop analyses and develop policy standards for common areas of concern. CCP12 members work toward the common purpose of creating conditions in which a global CCP solution can emerge to meet the needs of the marketplace.

The European Association of CCP Clearing Houses (EACH) represents the interests of central counterparties clearinghouses in Europe since 1992. EACH currently has 20 members from 15 different European countries.

This letter represents our joint response to the Board’s recently published consultation *Guidance on Continuity of Access to Financial Market Infrastructures (“FMIs”) for a Firm in Resolution* (“the consultation”). CCP12 and EACH very much appreciate the opportunity to provide comments to the Financial Stability Board (“FSB”) on this important issue as well as to participate in the workshop roundtable held in Basel on February 8<sup>th</sup>.

## Overview

We recognise that the consultation refers to FMIs as a group and the questions are addressed to the FMI community as a whole. We feel it is important to consider the unique roles of FMIs individually, rather than as a group, as different FMI types provide unique services that will require individual consideration. In particular, the firms represented by CCP12 and EACH are central counterparties and provide a service separate and distinct from other FMIs, such as payment systems. We understand the need to examine the impact of suspending access to critical CCP services, but suggest that regulators consider these impacts in relation to the materiality of services in question. In the wake of a resolution, access to clearing services may be less critical than access to the payment systems supported by other critical FMIs.

Broadly speaking, it is crucial that CCPs maintain the right to exercise appropriate flexibility to address stress events, including the resolution of a clearing member, or its affiliates or parent, as the facts and circumstances of the stress become known. As described in principle 2 of the Principles for Financial Market Infrastructure (“PFMIs”), CCPs “should have objectives that place a high priority on the safety and efficiency of the FMI and explicitly support financial stability and other relevant public interest considerations.” To meet these objectives and fulfil their role as risk managers and central

counterparties, CCPs have to retain the ability to limit access to their cleared markets if necessary to protect their cleared markets from potential contagion risk brought by a member in resolution.

As described in more detail below, CCPs are committed to the security and stability of their markets and are prepared to work with our members in response to a resolution event at their firm. We look forward to continued engagement with the regulatory community to work toward these shared goals.

## Response to Specific Questions

**1. Does the consultative document appropriately address the tensions that may arise between the various financial stability objectives, with regard to the safety and soundness of providers of critical FMI services on the one hand and to the orderly resolution of the recipients of such services on the other?**

CCP12 and EACH appreciate the consultation's expectation that "flexibility should be embedded in the process for imposing such additional requirements..." (consultation 1.3). In this point, the FSB rightly acknowledges the inappropriateness of setting firm actions in response to the resolution of a clearing member or its affiliates or parent. As noted in this same section, the FMIs should prioritise financial stability; achieving this goal necessitates that a level of flexibility be permitted in execution of the tools defined in their rulebook and CCP12 and EACH appreciate the FSB acknowledging this. This flexibility will be crucial to balancing the risk management and financial stability needs of the CCP and the orderly resolution of the service recipients.

**3. What are your views on the proposal in sub-section 1.1 of the consultative document that providers of critical FMI services clearly set out in their rulebooks or contractual arrangements the rights, obligations and applicable procedures in the event of an FMI participant entering into resolution?**

Section 1.1 set out that "the contractual rights and obligations and applicable procedures that would be triggered by entry into resolution of an FMI participant, its parent or affiliate, should be clearly set out in the rules or contractual arrangements". As explained in the following paragraphs, the risk management procedures set out in the CCPs regulations should be considered as a sound and effective framework to address the eventual resolution of participants, without requiring a specific new and separate regulation. The consultation should clarify that there is no obligation for CCPs<sup>1</sup> to establish a different regimen to address resolution.

CCP12 and EACH agree with the proposal in section 1.1 of the consultation that the CCP rules should clearly describe the tools available to the CCP under stress events. These rules should be publically available and easily accessible by clearing and other market participants to ensure that all parties are able to measure and monitor their current and potential obligation to the CCP. The rules act as contractual obligations that clearing members have agreed to as a condition of their membership.

The CCP's rulebook(s) already define the rights, obligations, and tools available to the CCP in the event of a clearing member entering into stressed situations or defaulting to the CCP. It is further understood, by CCPs and market participants, that the exercise of such rights and tools may be

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<sup>1</sup> As clarified during Basel workshop roundtable on February 8<sup>th</sup>.

subject to limitations and restrictions under applicable law, including resolution regimes. It is crucial that the potential impact of a default or stress event be known to the clearing member in advance of any such stress, and the rulebooks, along with any membership agreements or other material, ensure that clearing members are able to make this assessment and understand their full potential obligations.

The CCP's rules will require updating as markets mature to meet the changing and growing needs of participants. To facilitate these changes, CCPs will engage with participant representatives through the appropriate forums, such as risk committees, advisory committees, and consultations. Regulators will also be involved in the discussions on rule changes to review against regulatory standards and their explicit approval may be necessary. This process is designed to ensure that clearing members and other relevant market participants are fully informed at all times of their potential obligation to the clearing house in a market stress event.

We agree with the consultation that resolution of a clearing member or its the affiliates or parent should not automatically trigger default if it continues to meet all of its obligations to the CCP; this decision should be left to the CCP, acting in accordance with its risk management framework, the CCP rulebook and subject to the requirements of applicable law. Where appropriate and feasible, such actions should be taken in consultation with the resolution authority of the clearing member so that the implications of the resolution can be fully understood and, where appropriate, in communication with the CCP national competent authority.

As CCPs must be able to act to protect their cleared markets, the only way to avoid automatic triggering of a clearing member default is to provide the CCP with the necessary discretion to execute the appropriate tools, consistent with any applicable legal restrictions, to manage the risks that arise if the clearing member or its affiliates or parent enters into resolution. Defining firm responses in advance of an event could force the CCP to execute tools that are unsuited for the risks at the time or prevent the CCP from taking appropriate action at the time, creating additional, unnecessary risk for their markets.

CCPs cannot know in advance of a resolution event how the clearing member will be impacted or how markets will react. The variety and breadth of such events makes it impractical for CCPs to define an exact response for every potential stress events that comes from an affiliate or parent resolution. Defining the exact process in advance would be difficult as the CCP does not have sufficient visibility into a clearing member's parent or affiliates. Further, such firm definitions would be inappropriate for the active and flexible risk management required to manage such an event.

### **Affiliate Resolution**

We appreciate the interest of the Board in discussing the impact of a resolution event at a clearing member's affiliate. Typically, clearing members are individual entities within large corporate structures that can include dozens if not hundreds of affiliates. The consultation's proposal that CCPs describe their response to the resolution of a clearing member's affiliate suggests that all affiliates will be materially important to the clearing entity and its ability to meet its obligations to the CCP and its markets. Whilst we agree that some affiliates are sufficiently large and/or related to the clearing business that their resolution could have a detrimental impact on the clearing entity's ability

to continue its clearing business, it is important to recognise that this does not represent all of the affiliates of the clearing member.

Given the diversity of clearing members and the unique business strategy pursued by the parent and affiliate companies of each, it is impossible for the CCP to say how many or which of the affiliates would have a material impact on the clearing entity or indeed the overall parent. CCPs cannot maintain sufficient insight into the clearing member's business model to perform this analysis and the information necessary to perform this analysis would likely be beyond the scope of what clearing entities are able to share with the CCP. Therefore, it is impossible for CCPs to define in advance exactly the steps that will be taken when any affiliate goes into resolution. The impact of a single affiliate on the activity of its clearing entity cannot be known in advance and the CCP must have the flexibility to respond as necessary to protect its markets and support financial stability more broadly.

### **Resolution Authority Guarantee**

The assistance of the resolution authorities will be critical to the successful management of a resolution at a clearing member or its affiliates or parent. The authorities will be particularly crucial if they are able to guarantee the performance of the clearing member to their obligations at the CCP. As acknowledged in the consultation, the CCP should have the authority to default clearing members who are unable to continue meeting their obligations. If the resolution authority is able to guarantee these obligations, CCPs will be better positioned to provide continued access for clearing members in resolution, depending on the nature and scope of the guarantee. Even with such guarantee, CCPs must maintain the right to default a member based on their own assessment of the risks facing their markets, and the continuing viability of the clearing member, to protect their cleared markets and continue to promote financial stability.

**4. Sub-section 1.1 of the consultative document proposes that the exercise by the provider of critical FMI services of any right of termination or suspension of continued access to critical FMI services arising during resolution of an FMI participant be subject to appropriate procedures and adequate safeguards. What are your views on those procedures and safeguards? In your answer, distinguish where relevant depending on whether the firm that enters resolution continues or fails to meet its payment, delivery and collateral provision obligations to the FMI or FMI intermediary.**

The resolution of a clearing member or its affiliates or parent is an exceptional circumstance which, by its very nature, will have extraordinary and unpredictable causes and characteristics. The uniqueness of such events means it is impossible to define the specific procedures or safeguards to respond to the stress in advance. The procedures and safeguards undertaken in determining the appropriate steps in managing a clearing member affected by a resolution in their corporate structure are best left to the CCP, as the CCPs have the most experience with and expertise in their markets. In response to the financial crisis of 2008, G20 leaders agreed to implement a clearing mandate for specific over-the-counter products because CCPs had demonstrated an ability to protect against market instability and contagion in their markets.<sup>2</sup> CCPs must maintain significant flexibility to address the specifics of the extraordinary event facing the markets at that time.

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<sup>2</sup> <http://www.g20.utoronto.ca/2009/2009communique0925.html>

The determination of how to manage a resolution event at a clearing member or its affiliates or parent will largely rely on whether the clearing member entity continues to meet its obligations to the CCP. However, meeting these requirements is not necessarily the only consideration for a CCP in determining whether to permit continued access to the clearing markets in a resolution situation. A CCP may, for example, want to consider the expected continued viability of the entity as a clearing member going forward, its operational capacity, ability to perform other functions in default management, the potential impact on the clearing system if resolution is unsuccessful, and the position of the clearing house as compared to other creditors and potential creditors of the entity. Additionally, the catalyst of the resolution is an important consideration in a CCP response. For example, fraud and cyber events may require a different risk mitigation approach than capital or liquidity shortfall. As a result, we believe that the rights of the CCP to exercise a termination or suspension should not distinguish between actions based on the firm's resolution itself or based on the firm's failure to meet its obligations to the CCP, subject in any case to any temporary stay or other restriction under the relevant resolution regime.

Generally speaking, procedures and safeguards already exist at the CCP with regards to declaring the default of a clearing member. These are contained in the rulebooks and membership agreements that clearing members sign on to as a condition of their membership. CCPs are committed to providing the necessary transparency to ensure clearing members are able to assess and understand their obligations to the clearinghouse, as well as the potential consequences of not meeting those obligations.

To meet this transparency commitment, CCPs perform regular monitoring to proactively identify stress events that may impact their clearing members. During a stress event, CCPs maintain consistent communication with clearing members and, where possible, their regulator, to better understand the ultimate risk facing the cleared markets and other clearing participants.

Through this communication, CCPs can prepare to apply the most appropriate risk management tools to protect their markets and mitigate potential negative impacts on the affected clearing member. The communication and on-going monitoring supports the CCP's insights into the clearing member's business and total risks. This ensures the CCP is prepared to exercise its discretion to apply terminations or suspensions of continued access as appropriate to address the risk of the individual firm whilst also considering the risk of contagion to other clearing members and the cleared ecosystem. This discretion typically includes many tools that could be exercised in advance of termination or suspension that ensures the CCP gain the necessary transparency into the stress facing the firm and its affiliates or parent. Additional tools may allow the CCP to reduce the overall risk of the clearing member, ultimately reducing the need for a potential termination or suspension. Preferably, these steps would be determined after discussions with the appropriate authorities to ensure the CCP's actions will not have a detrimental impact on the clearing member, even as the CCP maintains the definitive right to exercise such actions.

Additional or burdensome procedures will unnecessarily constrain the CCP's ability to quickly implement tools to limit the impact of the stress and protect its cleared markets. These limitations will undermine the goals of international regulators focused on systemic stability and security of the financial markets.

The execution of the CCP's response to a clearing member's resolution will be conducted with proper regulatory oversight. CCPs are required to inform their own authorities in the event of a member default; the member will have engaged with its regulator in the event of the resolution of the affiliate/parent and will have to inform its regulator if it fails to meet its obligations to the clearinghouse. Historically, this communication has begun well in advance of the declaration of default, and we expect that it would include information sharing between the authorities for the CCP and clearing member. This oversight has been and will continue to be sufficient to ensure the broader interests of market participants and stability are considered in taking action in response to the resolution without creating unnecessary hurdles in the process.

**6. What are your views on the proposal in sub-section 1.4 of the consultative document that providers of critical FMI services should engage with their participants regarding the range of risk management actions and requirements they would anticipate taking in response to the resolution of an FMI participant? Does this strike the right balance between the objectives of orderly resolution and the FMI or FMI intermediary's prudent risk management?**

CCPs already describe the range of risk management tools available – during business-as-usual and market stress events – in their publically available rulebooks as well as in the membership agreements available to firms, as well as other public disclosure. This ensures that clearing members are able to evaluate their potential risk and liability as well as their ability to respond to potential exceptional actions by the CCP under a variety of circumstances. Changes to the rules or liabilities are disclosed to members and typically require a period of consultation to ensure clearing members and participants have a full understanding of their obligations at all times.

In addition to this existing and available documentation, clearing members typically perform regular due diligence on their CCPs, and CCPs make themselves available for such reviews. This generally includes due diligence questionnaires and on-site visits to the CCP.

As discussed above, CCPs will require a degree of flexibility in how and when they apply some of the tools described in its rulebook, as the risks facing their cleared markets in the event of the resolution of a clearing member or its affiliates or parent will largely depend on the exact circumstances of the specific event and cannot be known in advance. Whilst CCPs should engage with their membership via documentation and due diligence checks, it is not possible for this engagement to cover every possible circumstance.

When considering the impact of risk management actions and requirements, regulators should keep in mind the relative size of the obligations to the clearinghouse. During severe stresses, markets have supported significant variation margin calls, which are typically much larger than the size of the clearing member's obligations to the default fund, both funded and unfunded. The ability of firms to meet these obligations should suggest that they would be similarly able to meet their obligations to the CCP in the event of the resolution of a clearing member or its affiliate or parent.

**7. Do you agree with the proposal in section 2 of the consultative document that firms should be required to develop contingency plans to facilitate continuity of access in both the lead-up to, and upon entry into, resolution? Does the consultative document address all aspects of the information and analysis that may be required for such contingency plans?**



CCP12 and EACH agree that firms should plan for and ensure they have the ability to meet potential obligations in the event of market stress up to and including their own resolution or that of their affiliate or parent. We appreciate the consultation's position that "the ultimate responsibility for ensuring the financial and operational capability to continue to meet the conditions for access to critical FMI services lies with the firm itself."

However, as discussed in the questions above, CCPs have to maintain significant flexibility in defining how to manage the resolution of a clearing member or its affiliates or parent, subject to requirements of applicable law. This will significantly limit the amount of detail CCPs are able to provide for their clearing members' contingency plans. CCPs must maintain the ability to protect their cleared markets if a clearing member poses contagion risk, and as such cannot guarantee continued access during any given stress event.

We would ask that regulators recognise clearing members' contingency plans with regards to CCP access cannot be as specific as they may need to be for other critical FMI services. As CCPs do not provide the critical services of other FMIs, such as payment processing which may be more essential in a resolution event, we do not feel that it is necessary that these contingency plans include as much detail with regards to the CCP.

In particular, section 2.3 of the consultation asks firms to consider several potential actions by an FMI in response to a variety of circumstances to include in their contingency plans. Currently, the CCP's rulebook and regular reporting will allow clearing firms to understand their ultimate potential liability to the clearinghouse and plan accordingly, ensuring that much of the information suggested for inclusion in the firms' contingency plans is already available. However, the circumstances described in 2.3 represent exceptional events that CCPs will need flexibility to address as each will pose unique and unpredictable stresses to the CCP and its other market participants. CCPs will be unable to define answers to many of these questions, as the response cannot be known in advance of the stress event it is meant to address.

In particular, section 2.3 asks that a scenario of "cross default at another FMI" be considered as an example of a clearing member or its affiliates breaching a condition of access. In this example, we feel it is critical that the CCP be able to consider a cross default to another FMI in assessing the clearing member's ability to meet its clearing obligations. Whilst we do not believe that such an event should automatically trigger a default, if a firm fails to comply with its obligations to the CCP, the CCP must have the right to trigger default procedures. In this scenario, cross default remains relevant to CCPs.

**9. Does the consultative document identify all relevant requirements and pre-conditions that a firm may need to meet to support continuity of access in both the lead-up to, and upon, resolution? What other conditions or requirements, if any, should be addressed?**

We appreciate the consultation rightly putting the onus on clearing participants to ensure continuity of access to critical services, in particular in determining how the participant will continue to meet its obligations to its clearinghouses.

It is important to note that, however, just as CCPs cannot know define the exact response it will take in advance of resolution at a clearing member or its affiliates or parent due to the exceptional nature

of these rare events, there must be a degree of flexibility expected to manage the exact situation as it arises. CCPs will have to maintain this flexibility in order to protect cleared markets without exacerbating the stress on a clearing member in resolution.

**10. Does the consultative document identify appropriate methods for providing the information and communication necessary for key decision making during the resolution of an FMI participant? Are there additional safeguards that could be put in place that would ensure adequate levels of transparency in the lead-up to, and upon resolution?**

In the event of a clearing member's resolution, or that of its affiliates or parent, the CCP will require a significant amount of information from the clearing entity regarding the event and its impact on clearing activity. The CCP must be able to call for whatever information is necessary to inform their actions to limit the risk of contagion and additional stress on their markets. Given the exceptional nature of such an event, it is unlikely that the comprehensive data requirements will be known in advance, nor do we expect that communication systems and methods can be defined.

Methods for communication are already defined in the CCP rulebooks and/or member and participant agreements. In particular, the clearing member entity is required to alert the CCP in the event of a material change in their credit quality. This will frequently occur in advance of resolution, as stress begins to build up at the firm. Once the CCP has been informed, it will be in constant communication with the stressed clearing member to understand how the event will impact the clearing entity and its ability to continue to meet its clearing requirements. This ensures that the CCP can identify and gather the necessary information about the event and respond appropriately as the firm approaches resolution, potentially limiting the need to execute a suspension of clearing, whilst protecting the broader clearing market and other participants from contagion risk.

We also expect that the resolution authority of the clearing member or its affiliates or parent would inform the CCP as they identify that a firm is approaching resolution in order to establish communication with the CCP. As the resolution authority will likely have more information about the firm, particularly if the resolution occurs outside the cleared entity, it will be critical that the CCP be given sufficient information and evidence to ascertain if the clearing entity will be able to continue to meet its obligations to the CCP, whether through a guarantee from the resolution authority or via other means. Without information about the non-clearing entity, it will be difficult for the CCP to properly assess the risk of the resolution to their markets, the protection of which must remain their paramount concern. To ensure that all FMIs are able to address the resolution appropriately, we would ask that the consultation's proposal for information sharing between the authorities would be expanded to include all critical FMIs. With the appropriate safeguards, given the confidential and sensitive nature of the information related to resolution of a FMI participant, the collaboration and exchange of the necessary information among resolution authorities, FMI supervisors and FMI, in the lead up to resolution and in the process of resolution, is of the utmost importance. This collaboration would imply a wider degree of visibility to FMI (again, with the appropriate safeguards) of the resolution strategies, the resolution plans and the contingency plans.

The consultative document mentions in several points that "the resolution authorities should provide the FMI with information about the participant or any bridge institution to which its functions have been transferred". To the extent possible, and considering that CCPs are expected to actively and efficiently contribute to the continuity of the critical services of the firm in resolution,



the guidance should consider the possibility of advancing such relevant information to the critical FMIs involved.

CCPs are committed to limiting the impact of a stress event on its participant and cleared markets. This requires that all parties participate in on-going and open communication as stress events are identified in markets and entities that could impact the cleared market. CCP12 and EACH are encouraged by the work of the FSB on the consultation and we look forward to continuing to work with the authorities as this develops.

We appreciate the opportunity to provide comments to the FSB on this important matter and look forward to continuing to work together with regulators towards our shared goals of market stability and customer security.

Sincerely,



Lee Betsill  
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Simon Turek  
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