



**Financial Stability Board  
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21 October 2016

### **HSBC response to Essential Aspects of CCP Resolution Planning Discussion Note**

Dear FSB,

We welcome the opportunity to comment on the discussion note "Essential Aspects of CCP Resolution Planning".

As a general matter, HSBC participated in and supports the comments in the joint ISDA/FIA/IIF letter dated 21 October, including:

- Establishment of clear and transparent conditions for entry into resolution and transparency about the resolution plans.
- Maintenance of financial stability as key driving factors.
- Primacy of the rulebook: The resolution authority (RA) should honour the tools and their order in the rulebook, therefore implicitly be compliant with No Creditor Worse Off.
- Compensation of participants for losses allocated in recovery and resolution.
- Coordination with all affected authorities when planning, but clear responsibilities of the home RA for executing the resolution plan.
- Relaxation of clearing mandates and capital requirements for cleared derivatives to facilitate an orderly market and resolution of the CCP.

In addition to the issues raised in the ISDA/FIA/IIF letter, HSBC wanted to highlight the following areas: entry into resolution; pre-funded resources; and non-default losses.

For any questions on this response please contact Ulrich Karl, Director Financial Market Infrastructures, HSBC: [Ulrich.karl@hsbc.com](mailto:Ulrich.karl@hsbc.com)

Yours sincerely,

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## Entry into resolution

All recovery and resolution tools will affect market participants in negative ways. The tools supported by industry (partial tear-up and VM gains haircutting (VMGH) – see below) are the least bad tools amongst them. We therefore do not want the resolution authority to require additional tools and resources from those already provided by the rulebook. Consequently we accept that the RA will step in at a well defined point consistent between CCPs, when there are still resources in the waterfall. This can be after the funded resources are used up, or after the first assessment. We agree with the ISDA paper that the point of entry should not be a hard trigger, but allow flexibility. Should the default management process still work, i.e. the auctions still provide bids but the CCP might require a small fraction of the resources reserved for the RA to complete the recovery, the RA could decide not to trigger resolution.

VMGH comes after assessments in the waterfall. The RA stepping in earlier automatically means that this tool will only be used in resolution. As VMGH allocates losses widely, participants should gain comfort when the tool is executed by an impartial authority and not the CCP which will at this point likely be focussed on its own survival. Applying these tools by the RA will also allow the RA to take the systemic impact of these tools into account.

## Pre-funded resources

We support appropriately sized capital requirements for a CCP, including capital for operational and investment losses. We also support the CCP having to keep six to twelve months of operational expenses to cover a phase of wind-down. We however do not support requirements for the CCP to pre-fund resources for an event that is by definition far beyond “extreme but plausible”. The CCP would likely pass the cost of these resources to clearing participants in the form of higher fees, resulting in the system paying for resources that are only used in implausible events. We do not consider this to be an efficient use of funds. A more appropriate solution would be to use a mix of resolution resources in the waterfall, voluntary re-capitalisation, funds of the parent and loss allocations to participants in line with an insolvency counterfactual as a last resort in resolution.

## Non-default losses (NDL)

As highlighted in the ISDA/FIA/IIF letter, non-default losses stem from risks that are managed primarily (if not exclusively) by the CCP. We are concerned by the lack of transparency to clearing participants, who have neither visibility over the risks nor the ability to manage them. To address this, we propose significant additional disclosure obligations should be considered for CCPs, so that clearing members and participants can evaluate how well a CCP is managing its risk.

For non-default losses that the CCP cannot not pay for in their course of BAU business or recovery, we propose the following order of loss allocation in resolution:

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- As a first step, all CCP equity should be used to cover NDLS
- The CCP's parent should then contribute (e.g., by posting a guarantee or security pledge in an amount that is at least equal to the sum of all profits upstreamed for the prior three years)
- The resolution authority should seek a voluntary solution (which we believe may be viable as the clearing business of a CCP suffering extreme NDL is likely to be uninterrupted in such a situation and the CCP should still have considerable value. If so, then a clearing participant – or other third party - might want to take the remaining losses and recapitalise the CCP.)
- Failing a voluntary solution, remaining losses should be allocated as part of resolution to all clearing participants (brokers and clients) in line with the losses each participant would have suffered in insolvency/bankruptcy (No Creditor Worse Off with insolvency as counterfactual). Parties who suffer losses should be compensated with equity in the new CCP.
- Clearing participants should only be required to re-capitalise the CCP when no voluntary solution can be arranged. In any case it is important to balance the equity that participants receive in exchange for losses they got allocated, and equity the new owners receive for recapitalisation. This balance needs to be well calibrated as to fairly compensate loss-takers as a form of bail-in, and provide incentives for third parties to invest in such a CCP.