

Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Sent by email: fsb@bis.org

28 November 2014

Dear Sir or Madam,

LCH.Clearnet Group Limited (“LCH.Clearnet” or “The Group”)¹ appreciates the opportunity to comment on the Financial Stability Board’s (“FSB’s”) consultative document on “Cross-border Recognition of Resolution Action.”²

LCH.Clearnet’s response focuses on the portion of Section 2 of the consultative document that addresses the use of contractual recognition clauses to support the enforceability of temporary stays on early termination rights in financial contracts. LCH.Clearnet requests that FSB clarify that such temporary stays should not apply to rights of a financial market infrastructure (FMI) that is dealing with the resolution of an FMI participant. This approach is consistent with the FSB’s views in the October 2014 version of “Key Attributes of Effective Resolution Regimes for Financial Institutions.”³

LCH.Clearnet also requests that the FSB clarify that the situation outlined in Scenario 4a in the Annex to the consultative document on the write-down of liabilities should not apply to a situation where an FMI participant in resolution has obligations to the FMI. This approach is also consistent with the FSB’s views in the Key Attributes document.

The LCH.Clearnet is the leading multi-asset class and multi-national clearing house, serving major international exchanges and platforms as well as a range of OTC markets. It clears a broad range of asset classes, including: securities, exchange-traded derivatives, commodities, energy, freight, foreign exchange derivatives, interest rate swaps, credit default swaps and euro, sterling and US dollar denominated bonds and repos. LCH.Clearnet works closely with market participants and exchanges to continually identify and develop innovative clearing services for new asset classes. LCH.Clearnet Group Ltd is majority owned by the London Stock Exchange

¹ LCH.Clearnet Group Limited consists of three operating entities: LCH.Clearnet Limited, the UK entity, LCH.Clearnet SA, the Continental European entity, and LCH.Clearnet LLC, the US entity. Link to Legal and Regulatory Structure of the Group:
http://www.lchclearnet.com/about_us/corporate_governance/legal_and_regulatory_structure.asp

² The consultative document is available at http://www.financialstabilityboard.org/publications/c_140929.pdf

³ The Key Attributes document can be found at
http://www.financialstabilityboard.org/publications/r_141015.pdf

Group (“LSEG”), a diversified international exchange group that sits at the heart of the world’s financial community.

General comments

LCH.Clearnet appreciates the importance of FSB’s efforts to take steps to enhance the effectiveness of resolution actions for cross-border groups. LCH.Clearnet supports these efforts. However, the FSB should make it clear that these efforts are not intended: (1) to create obstacles to the ability of a CCP to exercise the rights available under its rules if a participant in resolution, or a successor firm, fails to meet its obligations to the CCP; (2) to prevent a resolution authority from giving due regard to ensuring the continued safe and orderly operation of the CCP before the resolution authority imposes a temporary stay on the CCP’s power to take action against a participant based only on the entry of the participant into resolution; or (3) to undermine the ability of a CCP to continue to provide clearing services to a participant in resolution by writing down the liabilities owed to the CCP.

Response to Question 3(i)

Q8. Do you agree that achieving cross-border enforceability of (i) temporary restrictions or stays on early termination rights in financial contracts and (ii) ‘bail-in’ of debt instruments that are governed by the laws of a jurisdiction other than that of the issuing entity is a critical prerequisite for the effective implementation of resolution strategies for global systemically important financial institutions (G-SIFIs)? Is the effective cross-border implementation of any other resolution actions sufficiently relevant for the resolvability of firms that the FSB should specifically consider ways of achieving their cross-border enforceability?

According to the consultative document, FSB members have worked with ISDA to craft a draft protocol to the ISDA Master Agreement that would support the cross-border enforcement of a temporary stay of early termination rights with respect to financial contracts that are governed by the Master Agreement.⁴ As a contractual solution, the draft protocol will only bind the parties that agree to it. A number of global systemically important banks (G-SIBs) have announced that they will sign the draft protocol.⁵ The draft protocol will take effect from January 1, 2015 and will govern both new and existing trades between adhering parties. The consultative document discusses how FSB members could support adoption of contractual language, like the ISDA draft protocol, that implements stays of early termination rights for financial contracts by firms that are prudentially regulated or within the scope of resolution regimes, and for counterparties of these firms that are not subject to prudential regulation.⁶ The consultative document also urges FSB members to support statutory changes to give effect to temporary stays of early termination rights for financial contracts, statutory changes being necessary to address the limitations of contractual solutions.

The consultative document does not specifically mention CCPs or address whether the FSB expects CCPs to accept temporary restrictions or stays of early termination rights for cleared financial contracts. LCH.Clearnet requests that FSB clarify in the final version of “Cross-border

⁴ Consultative document at. p. 12.

⁵ See, <http://www2.isda.org/news/major-banks-agree-to-sign-isda-resolution-stay-protocol>

⁶ Consultative document at. p.12-13.

Recognition of Resolution Action” that it does not intend for CCPs to be subject to either statutory or contractual temporary stays of the CCP’s ability to exercise the rights available under its rules if a participant in resolution, or a successor firm, fails to meet its obligations to the CCP, or to automatic stays if a participant is in resolution. This clarity would provide certainty to CCPs and their participants and, thus, promote effective resolution of a participant of a CCP. Additionally, this clarity would be consistent with FSB statements in other publications addressing resolution.

In Annex 1 of the recently updated “Key Attributes of Effective Resolution Regimes for Financial Institutions,” FSB states unequivocally that

If a participant in resolution fails to meet any margin, collateral or settlement obligations to the FMI, the FMI should retain the right to exercise any acceleration or early termination rights that arise as a result of that failure.⁷

This statement recognizes that the important position occupied by CCPs in the financial markets that they serve calls for a specific regime applicable to CCPs with a participant in resolution. Among the things that fundamentally set CCPs apart from other financial market participants is that they run matched books. Absent default, CCPs pass on collateral (or settlement) from loss-makers on losing positions to profit-makers. It is vital that they maintain the ability to do so on a timely basis, especially in stressed markets. A stay on a CCP’s rights to act with regard to the positions and collateral of a defaulter will jeopardise the CCP’s ability to service its non-defaulting users, which has negative implications for systemic stability.

Even where a participant in resolution continues to perform, a CCP may consider it necessary for risk management or operational reasons to take certain actions against the participant. Any stay imposed on a CCP with regard to a participant in resolution should not be an automatic stay but a power exercisable by a resolution authority that can take into account such considerations. Annex 1 to the recently updated “Key Attributes of Effective Resolution Regimes for Financial Institutions” is consistent with this approach.

The power for resolution authorities to impose a temporary stay on the exercise of contractual acceleration or early termination rights should apply to any such rights that are exercisable by an FMI that arise by reason only of the entry into resolution of, or the exercise of resolution powers, in relation to, an FMI participant. Any such power should be exercised in relation to an FMI with due regard to the need to ensure that it does not compromise the safe and orderly operations of the FMI.⁸

The statements in Section 3.1 of Annex 1 to the Key Attributes publication are consistent with current law in both the EU and US. The Bank Recovery and Resolution Directive (“BRRD”) in the EU and the orderly liquidation authority in Title II of the Dodd-Frank Act preserve the ability of a CCP to take action to default a participant, or the successor of a participant, that fails to perform to the CCP. Additionally, several provisions of BRRD exempt CCPs from automatic stays by resolution authorities and include language that closely tracks Section 3.2 of Annex 1 to the Key

⁷ October 2014 version of Key Attributes of Effective Resolution Regimes for Financial Institutions Section 3.1 at p. 73.

⁸ Id., Section 3.2 at p. 73.

Attribute on the need to exercise due regard to ensure that any stay does not compromise the safe and orderly operations of a CCP.⁹

Scenario 4a in the Annex to the Consultative Document

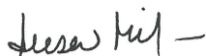
Scenario 4a in the Annex to the consultative document involves the writing down of claims by creditors by a home resolution authority and the ways that the relevant authority in a host jurisdiction of a distressed CCP participant could give effect to this measure. LCH.Clearnet asks the FSB to clarify that obligations owed by to a CCP by a CCP participant in resolution are not subject to this type of bail-in by resolution authorities. Under the Key Attributes, an effective resolution regime should ensure continuity of systemically important clearing and settlement functions including those provided by CCPs.¹⁰ The ability of a CCP to continue to clear for a participant in resolution is premised on the continued performance on obligations owed to the CCP by the participant or a successor firm. CCPs may not be willing or able to continue to provide these services to a participant in resolution if the participant's resolution authority has the ability to write down liabilities owed to the CCP. There are a number of reasons for this. Bail-in of the positions of the participant in resolution would leave the CCP with an unmatched book which is contrary to the fundamental design of CCPs. The existence of an unmatched book would complicate the efforts of the CCP to handle any default by the participant in resolution. Additionally, the resolution authority could bail-in the collateral posted to the CCP, which would lessen the resources available to the CCP to manage any default by the participant in resolution. Clarity by the FSB that obligations owed to CCPs should not be subject to bail-in by resolution authorities would support the ability of CCPs to continue to provide services to participants in resolution or successor firms.

Conclusion

LCH.Clearnet requests that the final version of "Cross-border Recognition of Resolution Action" clarify that FSB does not intend for CCPs to be subject to either statutory or contractual temporary stays of the CCP's ability to exercise the rights available under its rules if a participant in resolution, or a successor firm, fails to meet its obligations to the CCP and that, in all other cases, any stay imposed will in any event not be an automatic stay but a power exercisable by the resolution authority with due consideration for the continued safe and orderly operations of the CCP. LCH.Clearnet also requests that the FSB clarify that liabilities due to a CCP in connection with cleared derivatives should not be subject to bail-in in the form of a write-down of liabilities.

LCH.Clearnet hopes that FSB finds this contribution useful. Please do not hesitate to contact Susan Milligan at +1 202 349 4047 regarding any questions raised by this letter or to discuss these comments in greater detail.

Yours faithfully,



Susan Milligan
Head of US Public Affairs

⁹ See, Sections 69, 70 and 71 of BRRD

¹⁰ Key Attributes at p. 71.