1 February 2019

Via email
fsb@fsb.org

Re: Financial resources to support CCP resolution and the treatment of CCP equity in resolution

ASX welcomes the opportunity to provide its views to the FSB on the FSB's discussion paper entitled: "Financial resources to support CCP resolution and the treatment of CCP equity in resolution".

1. Introduction and Overview

The ASX Group ("ASX") operates licensed markets and post trade infrastructure (central counterparties and settlement facilities) for exchange traded and OTC financial products, across multiple asset classes – equities, interest rates, commodities and energy. ASX operates two licensed CCPs: ASX Clear ("ASXC") and ASX Clear (Futures) ("ASXCF"). Further detail on the regulatory framework under which ASXC and ASXCF operate in Australia is set out in *Appendix 1.*

ASXC provides a multi-asset class central clearing facility for cash equities, structured products, warrants, listed interest rate securities and a range of options products.

ASXCF provides multi-asset class central clearing for Futures and OTC Derivatives covering rates, commodities and equities.

To add further context for this submission, ASX has placed significant skin in the game ("SITG") in its two CCPs. ASXC's A$250 million default fund is 100% ASX capital, and ASXCF's default fund is 67% ASX capital with ASX providing A$450 million out of the A$650 million total fund size.

2. Public consultation response

ASX provides a summary of its position on the discussion paper and CCP resolution below, with a focus on the section **"Treatment of CCP Equity in Resolution".**

Question 10: Should the treatment of CCP equity in resolution take into account different ownership structures?

Guidance should have regard to different structures
It is important that any guidance on CCP resolution have regard to the differences in CCPs and the regulatory environments in which they operate. Financial market infrastructure groups can have very different ownership, legal and organisational structures and offer different types of products, and those differences are relevant to both implementation of resolution regimes and resolution planning. Regard should also be had to the regulatory framework and rules under which the CCP operates and the levels of capital, recovery waterfalls and commercial arrangements for the CCP.

Question 11: What are your views on the possible mechanisms for adjusting the exposure of CCP equity in bearing loss in resolution set out in Section A?

Regarding Section (A)(III) Transferring critical CCP operations to a bridge entity and placing the remnant CCP into liquidation/receivership:

ASX believes that there should be no selective transfer to bridge or new CCP

If the resolution authority transfers contracts to a bridge or new CCP it should not be able to 'cherry pick' contracts for transfer (particularly if this changes the basis for allocation of losses from that contemplated in the rules). In particular, all contracts with the same counterparty and subject to the same netting arrangement must be transferred together or left behind and where liabilities under market netting contracts are secured by collateral held by the central counterparty, the liabilities and the associated collateral must be transferred together or left behind.

Question 14: Regarding Section (D) ASX suggests the following policy considerations to the FSB:

Compensation and use of equity from CCPs not appropriate

There should be no basis for compensation of participants/creditors if the default loss allocation regime is comprehensive, and the rules are followed. If compensation is payable in resolution (but not recovery), this could create incentives for participants to prefer resolution and not fully participate in the CCP's recovery processes.

The use of a CCP's financial resources should be determined in consultation with the regulatory authority in advance of distressed market situation and set out in the CCP's rulebook to provide certainty as to what will generally occur in these situations.

CCPs such as those in the ASX Group commit significant financial resources in the default waterfall which is part of the recovery plan. The provision of further equity is not required or appropriate. De-capitalising a CCP in distressed market conditions could have a significant impact on financial system stability by creating uncertainty and reducing the ability of the CCP to take the actions required. It is important to preserve the CCP's independence after the resolution. Further, the use of CCP equity during resolution can affect the incentives for participants to be involved in the default management and recovery processes. The resolution authority should only be able to vary or cancel equity if it is necessary to achieve the objectives of the resolution process (e.g. recapitalisation).

The parent entity should not be involved

Resolution powers need to take account of different ownership structures. The ability to step in at parent level or to give rights to claim compensation against parent company equity would likely result in integrated groups restructuring their operation. A decision to de-integrate a CCP for this reason could result in the loss of significant efficiencies derived from the CCP's membership of the broader financial market infrastructure group, and a consequential increase in the cost of clearing. The resolution authority should only be able to 'step-in' to or direct related bodies corporate of a CCP to enforce existing contractual arrangements (e.g. service agreements or funding arrangements).

Question 16: How could authorities reconcile the expectations that equity bears loss in resolution with the 'no creditor worse off than liquidation safeguard'?

Importance of adhering to recovery rules

A resolution authority should be required to adhere to the CCPs recovery rules, and the no creditor worse off counterfactual should be assessed against the outcome if these rules were applied.

A guiding principle in the exercise of resolution powers must be that the resolution authority will adhere to the loss allocation and other recovery related powers in the CCP's operating rules. This is critical to the preservation of commercial certainty for participants and their clients as consumers of central clearing services. Market confidence in a CCP could be undermined by a resolution regime which empowered a resolution authority to step in and re-write the operating rules on the allocation

of losses or liquidity shortfalls, in the event the CCP should enter resolution.

ASX accepts the need for regulators to pay due regard to the hierarchy of claims under applicable insolvency law and the 'no creditor worse off' principle. However, these principles need to be applied in the context of an overriding principle that the resolution authority will adhere to the loss allocation and other recovery related powers in the CCP's operating rules. This is fundamental for the preservation of commercial certainty for participants and their clients as consumers of CCP services. This does not mean that the resolution authority should not have 'ancillary' powers that it can exercise in a way that is complementary to the loss allocation regime under the operating rules (e.g. power to make a temporary injection of funds, where this is likely to be less disruptive than use of other recovery powers. But it does mean that the resolution authority should rely on the pre-agreed suite of tools to allocate among participants any losses and liquidity requirements that cannot be avoided through reliance on ancillary powers conferred by the resolution regime.

3. Contact

ASX would welcome further discussion on this submission and its views on CCP resolution. Should you have any questions about this submission please do not hesitate to contact Hamish Treleaven, Chief Risk Officer, ASX at +61 2 9227 0949 or Hamish.Treleaven@asx.com.au.

Yours sincerely,

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Appendix 1 – Overview of ASXCF's regulatory framework

Australian regulatory framework

ASXC and ASXCF are both Australian Clearing and Settlement facility licensees ("**CS facility licensee**") which operate in a highly regulated environment overseen by two independent government agencies – the Australian Securities and Investments Commission ("**ASIC**") and the Reserve Bank of Australia ("**RBA**"). These government regulators have extensive powers to enforce the comprehensive laws and regulations that govern financial markets in Australia.

Under the *Corporations Act 2001* (Cth) ("**Corporations Act**"), the relevant Government Minister ("**the Minister**") has primary responsibility for licensing CS facilities operating in Australia and has the power to disallow amendments to the operating rules of CS facilities. ASIC assesses each CS facility licensee on its compliance with its licence obligations under the Corporations Act.

Under the Corporations Act, a CS facility licensee must, (among other things), to the extent that it is reasonably practicable to do so:

- comply with the Financial Stability Standards ("**FSS**") adopted by the RBA and do all other things necessary to reduce systemic risk. The FSS are aligned with the requirements of the CPMI-IOSCO Principles for financial market infrastructures ("**PFMIs**"). These standards address matters (including credit and liquidity risk, margining, acceptable collateral and financial resources) that promote the maintenance of a sound and efficient financial system and avoid the risk of significant damage arising from a Clearing Member failure. The RBA conducts an annual assessment of how well licensed CS facilities have complied with the RBA's FSS and done all other things necessary to reduce systemic risk. The RBA publishes its findings on its website.

- do all things necessary to ensure that its services are provided in a fair and effective way and have adequate arrangements for supervising the facility including arrangements for handling conflicts of interest between its commercial interests and regulatory obligations.