

July 31, 2020

VIA Electronic Mail

Secretariat to the Financial Stability Board  
Bank for International Settlements  
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**RE: Guidance on financial resources to support CCP resolution and on the treatment of CCP equity in resolution**

Ladies and Gentlemen:

The Depository Trust & Clearing Corporation (“DTCC”) welcomes the opportunity to comment on the consultative document issued on May 4, 2020 by the Financial Stability Board (“FSB”) entitled “Guidance on financial resources to support CCP resolution and on the treatment of CCP equity in resolution” (the “Consultative Document”).<sup>1</sup> DTCC recognizes the importance of the FSB’s efforts on this topic and appreciates the FSB’s continued engagement with regulators, clearinghouses (“CCPs”) and industry groups on this topic. Though the Consultation Document poses a series of questions grouped around specific themes and issues, rather than provide responses to individual questions, we have focused our response around these issues thematically. We also wish to reiterate the comments DTCC provided to the FSB’s 2018 discussion paper,<sup>2</sup> which remain relevant to the issues set forth in the Consultative Document.<sup>3</sup>

DTCC is well positioned to comment on the Consultative Document. DTCC is the parent company and operator of The Depository Trust Company (“DTC”), the U.S. central securities depository, and the U.S. cash market securities CCPs, National Securities Clearing Corporation (“NSCC”) and Fixed Income Clearing Corporation (“FICC”), each of which have been designated as systemically important financial market utilities (“SIFMUs”) by the U.S. Financial Stability Oversight Council (“FSOC”) pursuant to Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”). NSCC

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<sup>1</sup> See FSB, Consultative document entitled “Guidance on financial resources to support CCP resolution and on the treatment of CCP equity in resolution” (May 4, 2020), available at <https://www.fsb.org/wp-content/uploads/P020520.pdf>

<sup>2</sup> See FSB, Discussion paper for public consultation entitled “Financial resources to support CCP resolution and the treatment of CCP equity in resolution” (Nov. 15, 2018), available at <http://www.fsb.org/wp-content/uploads/P151118-2.pdf>

<sup>3</sup> See DTCC comment letter, dated February 1, 2019, Murray Pozmanter, Managing Director, Head of Clearing Agency Services & Global Operations, DTCC.

and FICC provide critical clearing and settlement services for multiple asset classes, including US equities, corporate and municipal bonds, and government and mortgage-backed securities. DTC, NSCC and FICC are registered under the Securities Exchange Act of 1934, as amended, as clearing agencies, are supervised by the U.S. Securities and Exchange Commission (“SEC”). In addition, DTC is licensed as a New York Limited Purpose Trust Company and state member bank of the Federal Reserve System and, as such, is subject to supervision and examination by the New York State Department of Financial Services and the Federal Reserve Bank of New York under delegated authority from the Federal Reserve. As the parent company and operator of these user owned and governed SIFMUs, our primary focus is continuity of services to our member users (who are also our shareholders) and preserving market stability.

Each SIFMU is subject to the requirements contained in the Exchange Act and in the SEC’s regulations and rules thereunder. These requirements include enhanced standards under Exchange Act Rule 17Ad-22(e) for “Covered Clearing Agencies” (the “Covered Clearing Agency Standards”),<sup>4</sup> which, among other things, require covered clearing agencies to establish and implement policies that include, as part of their comprehensive risk management framework, plans for both recovery and orderly wind-down.<sup>5</sup> Each SIFMU has established and implemented recovery and wind-down plans approved by the SEC under its rule approval process and authority.<sup>6</sup> In addition, in accordance with the Clearing Agency Standards and the Principles for Financial Market Infrastructures (“PFMI”) published by the Committee on Payments and Market Infrastructures (“CPMI”) and the International Organization of Securities Commissions (“IOSCO”),<sup>7</sup> each SIFMU publishes qualitative and quantitative disclosures to provide members and the marketplace with transparency regarding their governance structure, key services and the methods they use to manage the risks to themselves and others in providing these services. In other words, these disclosures are intended to “provide sufficient information to enable participants to have an accurate understanding of the risks and costs they incur by participating in the [financial market infrastructure].”<sup>8</sup>

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<sup>4</sup> Recognizing that the Principles for Financial Market Infrastructures “is the relevant international standard for systemically important financial market infrastructures, such as covered clearing agencies,” the SEC has stated that “the requirements applicable to clearing agencies set forth in the Exchange Act and the rules thereunder, including the [the Covered Clearing Agency Standards], are consistent with the standards set forth in the [principles]”. Standards for Covered Clearing Agencies, Exchange Act Release No. 34-78961, 81 Fed. Reg. 70786, 70789 (Oct. 13, 2016).

<sup>5</sup> See Rule 17Ad-22(e)(3)(ii)

<sup>6</sup> The Depository Trust Company; Order Approving a Proposed Rule Change, as Modified by Amendment No. 1, to Adopt a Recovery & Wind-down Plan and Related Rules, Exchange Act Release No. 34-83972; File No. SR-DTC-2017-021 (August 28, 2018); National Securities Clearing Corporation; Order Approving a Proposed Rule Change, as Modified by Amendment No. 1, to Adopt a Recovery & Wind-down Plan and Related Rules, Exchange Act Release No. 34-83974; File No. SR-NSCC-2017-017 (August 28, 2018); Fixed Income Clearing Corporation; Order Approving a Proposed Rule Change, as Modified by Amendment No. 1, to Adopt a Recovery & Wind-down Plan and Related Rules, Exchange Act Release No. 34-83973; File No. SR-FICC-2017-021(August 28, 2018).

<sup>7</sup> See Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions, Principles for financial market infrastructures (Apr. 16, 2012), *available at* <http://www.bis.org/publ/cpss101a.pdf>.

<sup>8</sup> See CPMI-IOSCO, Principles for financial market infrastructures: Disclosure framework and Assessment methodology (December 2012) (“PFMI Disclosure Framework”), *available at* <https://www.bis.org/cpmi/publ/d106.pdf>.

## EXECUTIVE SUMMARY

DTCC understands the importance of maintaining adequate resources and tools that are available for resolution and the desire to understand the potential impact certain resources and tools may have on financial stability in a resolution scenario. While we support efforts to improve CCP resiliency to reduce systemic risk in the financial markets, we have significant concerns that the proposed guidance is too prescriptive and will not ultimately result in the desired certainty or transparency. Further, and with the understanding that the actual resolution strategies and planning for certain CCPs by the resolution authorities are still in development in many jurisdictions, we continue to believe that additional work providing transparency into the resolution authorities' decision-making is both necessary and advisable to provide greater clarity to both CCPs and their participants. Greater transparency in this regard will also enable CCPs and their participants to better understand and assess subsequent action with respect to resolution. Absent this transparency, we are concerned that any such subsequent action risks overshadowing or contradicting the substantial work regulators, CCPs and their stakeholders have undertaken to further CCP resilience and recovery planning.

More specifically, and as discussed in greater detail below, DTCC wishes to make the following points:

- Resolution authorities should be transparent and solicit public comment as to how the scenarios for evaluating existing tools and resources are being developed, what factors are being used to determine whether resolution is called for, and the amount of CCP resources they believe are adequate to support it.
- DTCC is supportive of resolution authorities coordinating with a CCP's supervisory regulator in assessing the adequacy of financial resources to absorb CCP losses. We further believe, however, when the CCP's designated resolution authority is not the same as the CCP's supervisory authority, it is paramount for transparency and market stability that the rules covering a CCP's recovery and wind-down plans, and regulatory capitalization requirements not be superseded by those of the resolution authority.
- Consideration by the resolution authority of the implications arising from a CCP's ownership and governance model, and the risks posed by the products it clears, should not be limited to the impact these factors have on the availability of resources in resolution, but should be taken into account at each stage of the resolution planning process.
- We do not believe a mandate by resolution authorities for CCPs to set aside financial resources solely for resolution, nor a requirement that CCPs reimburse members for financial resources contributed in resolution, is appropriate for CCP resolution plans. Such actions risk unnecessarily increasing the costs of clearing while at the same time negatively impacting the incentives that have been thoughtfully designed by CCPs and their participants.

## **I. Assessing the adequacy of financial resources to support CCP resolution**

### **A. The Importance of Transparency**

The framework of the Consultative Document is consistent with the structure of discussion paper, in terms of establishing a five-step process for assessing the adequacy of financial resources and tools available to support the resolution of a CCP. These steps include identifying hypothetical default and non-default loss scenarios and conducting a qualitative and quantitative evaluation of existing resources and tools available to authorities to support resolution of the CCP. DTCC agrees that such an approach may be an effective means for a resolution authority to assess the types of circumstances that could lead to resolution of a CCP. However, we believe that the scenarios presented are in some cases beyond extreme but plausible, and overall lack the necessary level of transparency as to the specific factors, both qualitative and quantitative, that would be used by the resolution authority in determining whether the CCP's financial resources are sufficient and what those factors are being measured against.

There are a wide range of risk tools utilized by CCPs (including hypothetical stress tests and sensitivity analyses) that are designed to measure the impact of price shocks which are not based exclusively on historical observations. In DTCC's view, the Consultative Document does not make clear that the most likely scenario that would lead to resolution of a CCP is a systemic risk event involving the simultaneous default of multiple global systemically important bank ("GSIB") participants. The impact that this type of extraordinary event could have on the financial system makes the amount of necessary CCP resources in resolution difficult to quantify. In such circumstances, there would also be CCP and government regulatory actions that would need to be contemplated by the resolution authority in connection with any actions to be taken. Moreover, CCPs have done a considerable amount of planning to prepare for the impact of various potential default and non-default scenarios. For example, DTCC engaged in extensive communications with its membership in February 2020 regarding pandemic planning and as a result, members were better able to be in a position to satisfy margin calls that were made in March 2020, at the height thus far of the pandemic-related market volatility.

DTCC strongly encourages the FSB to consider including in the guidance a requirement that resolution authorities create a template with clear factors covering each of the scenarios. Further, and to the extent practicable, resolution authorities should make public what they are considering in developing their resolution plans through a process of soliciting public comment and supervisory authority input, as well as making available impact studies and assessments of systemic risk mitigation. As registered clearing agencies, and designated SIFMUs, each of the DTCC clearing agencies are required to provide numerous forms of disclosure to its membership and to the marketplace covering, among other things, risk management, margin calculations, fees, and recovery and wind-down planning. The disclosures provided by the SIFMUs under the Disclosure Framework, the SEC rule filings made in connection with the wind-down plans, and the associated wind-down rules are intended to provide transparency to our members and the marketplace. As a result, they are able to measure, monitor and manage the costs, risks, and expectation associated with participating in the service and conduct their own risk management. We believe this same level of transparency and disclosure in relation to the resolution authority's considerations and planning should also be required.

Without adequate transparency, CCPs and market participants are not able to understand the expectations of the resolution authority with respect to use of the CCP's resolution strategy versus the anticipated timing of any intervention by the resolution authority. The CCPs are also not in a position to

determine whether and the degree to which what is being considered deviates from the CCP's existing stress testing, recovery structure and capitalization plans. A lack of transparency also poses risk that the plans being developed by resolution authorities will leave out important levels of stress testing, timing implications and recovery indicators that are used by CCPs in evaluating their existing plans. This could result in resolution authorities stepping in prematurely in advance of the CCP's recovery tools being able to be used to the fullest extent possible.

## **B. Consideration of the Role of the CCP's Supervisory Authority**

The Consultative Document highlights the importance of close coordination between the resolution authority and the relevant oversight and /or supervisory authorities for the CCP that perform assessments of the adequacy of financial resources in the context of recovery planning. DTCC is supportive of, and encourages, such coordination. However, we believe a resolution authority should not serve as a substitute for the judgment of the CCP's supervisory authority where the resolution authority is not the CCP's supervisory or prudential authority. This is due to the inherent risk that exists by virtue of a resolution authority's lack of direct knowledge of the CCP's operations and risk management processes. As such, adequate consideration must be given to the knowledge obtained by the supervisory authority with respect to the CCP's ownership, capital structure, business services and products cleared, and recovery and wind-down plans, through the on-going supervisory process and the insight they have obtained through examinations conducted.

In the event there is any conflict between the financial resources requirements that the CCP is subject to by its supervisory authority and those that the resolution authority deems adequate, the resolution authority's proposed requirements should be subjected to a separate notice and comment process consistent with the standard rule-making process in the jurisdiction applicable to the CCP. This transparency is necessary to avoid creating confusion and to provide the clarity that members and clients typically receive under the existing applicable legal frameworks. For example, in the case of the DTCC clearing agencies, the CCPs' recovery and wind-down plans were filed with the SEC and were subject to public comment and SEC review.<sup>9</sup> These plans, and associated rules, therefore cannot be modified without going through a public comment process. DTCC believes that transparency in this regard is critical to ensure consistency and continued trust in the system, which is vital for CCPs to be able to continue providing its services through its recovery process as well as through a potential resolution.

In addition, when evaluating the availability, costs and benefits of potential means of addressing identified gaps between existing financial resources and resolution costs,<sup>10</sup> DTCC believes that resolution authorities must take into account the fundamental differences between CCPs and banks. The regulatory capital requirements and available financial resources required to be maintained by banks is based upon

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<sup>9</sup> The rules of the DTCC CCPs are filed with and reviewed by the SEC. As clearing agencies registered under Section 17A of the Exchange Act, self-regulatory organizations subject to Section 19 of the Exchange Act, and SIFMUs under Title VIII of Dodd-Frank, the CCPs are required to follow: (1) a specified process whenever a clearing agency proposes a new rule or a change or amendment to its Rules (a "Proposed Rule Change," and the process, the "Proposed Rule Change Process") and (2) a specified process whenever it proposes to make a change to its rules, procedures or operations that could materially affect the nature or level of risks presented by the clearing agency, the "Advance Notice" process.

<sup>10</sup> See Consultative Document, page 13.

their business models, market activity, and risk profiles that are inherently different from CCPs, whose primary functions are to ensure performance of financial contract obligations and manage risk.<sup>11</sup>

### C. Different Types of CCP Ownership Structures and Products Cleared

The Consultative Document contemplates that the resolution authority should consider, among other factors, implications arising from “the specific *types of products cleared*, arrangements for loss-sharing or segmentation across different clearing services, and *CCP ownership structures* on the availability of the various potential loss absorbing resources in resolution.”<sup>12</sup> DTCC believes that resolution authorities must take into account a CCP’s ownership model and products cleared, at each stage of the resolution planning process, not just on a macro-level basis when reviewing the availability of loss absorbing resources.

As a user-owned and governed utility, DTCC operates from the premise that the financial resources necessary for loss mutualization will be provided by its members, when needed, given the alignment of interests in continuity of DTCC’s critical services. DTCC’s unique ownership and governance structure provides for such an alignment of interests and incentives regarding default management and recovery between its users (who are also its shareholders), and the board of directors. The DTCC common shareholders include hundreds of banks, broker dealers, and other companies in the financial services industry that are participants of one or more of DTCC’s SIFMU subsidiaries. Under this structure, DTCC’s SIFMU subsidiaries are subject to the oversight of the board of directors<sup>13</sup> that advises on a variety of topics, including risk management, and is managed on a day-to-day basis by DTCC’s senior management. For example, each of the SIFMU’s loss allocation waterfalls, covering default and non-default losses, are governed by the SIFMU’s rules, which were subject to an extensive internal DTCC governance process, as well as the SEC’s public comment and approval process.

DTCC is also somewhat unique in terms of the products cleared. As noted above, products cleared is a factor that must be considered by resolution authorities in determining capital and replenishment approaches to CCP resolution frameworks throughout each step of the resolution planning process. In contrast to derivative CCPs, the majority of products cleared by the SIFMUs settle on a T+1 and T+2 basis, and do not have lengthy settlement timeframes, nor present extended open exposure to the clearing agency. As such, default liquidity risk with respect to the DTCC SIFMUs consists of short-term funding that is replenished as security settlements are completed on behalf of the defaulting member(s).

## II. Treatment of CCP equity in resolution

Part II of the Consultative Document notes that some CCPs allocate portions of non-default losses, particularly those arising from investment or custody risks, to clearing members. As a result, actions in resolution that expose CCP equity to larger default or non-default losses than would be the case in liquidation under the applicable insolvency regime could, based on the relevant “No creditor worse off in liquidation” (“NCWOL”) counterfactual, enable equity holders to raise NCWOL claims. This part of the

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<sup>11</sup> Cox, Robert T., and Robert S. Steigerwald, “A CCP is a CCP is a CCP” (April 2017), Federal Reserve Bank of Chicago Working Paper No. PDP 2017-01.

<sup>12</sup> See Consultative Document, page 6 (emphasis added).

<sup>13</sup> The DTCC Board of Directors is currently composed of 20 directors. Of these, 13 are participant directors that represent clearing agency members, including broker/dealers, custodian and clearing banks and investment institutions.

Consultative Document further lays out possible adjustment mechanisms that resolution authorities could use to adjust the exposure of CCP equity to losses in resolution to provide adequate resources for an orderly resolution. There is also a discussion of whether a CCP's rules should enable members to claim reimbursement from the CCP for any financial resources contributed in resolution that exceed the amount provided for in the CCP's recovery arrangements.<sup>14</sup>

Requiring a user-owned CCP to set aside financial resources for resolution through use of a debt instrument such as "Total Loss Absorbing Capacity" ("TLAC") or to change its rules to enable clearing members to claim reimbursement from the CCP for any financial resources contributed in resolution, would disrupt the alignment of interests among its user-owners, board of directors and management. Because members (who are owners) would be the parties contributing such resources, this may have the effect of disincentivizing members to do so, which would negatively impact participant access and continuity of the SIFMUs' critical services.

Further, as DTCC detailed in a prior comment letter,<sup>15</sup> we believe that the FSB should not mandate the provision of equity to CCP members. While DTCC agrees that resolution authorities should be able to write down or bail-in equity or unsecured debt in a manner that respects the insolvency claims hierarchy, including the NCWOL counterfactual, we do not believe that any form of mandated TLAC applicable to G-SIBs or, in the EU, minimum own funds and eligible liabilities ("MREL") requirement, is appropriate for CCP resolution plans. As discussed above, CCPs have fundamentally different business models and risk profiles than banks, and the regulatory capital requirements imposed on CCPs through its applicable rule-making and supervisory authority should govern.

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DTCC appreciates the opportunity to respond to the issues raised in the Consultative Document and your consideration of the views expressed in this letter. We would welcome the opportunity to provide further detail on any of the matters discussed herein. If you have any questions or need further information, please contact me at [mpozmanter@dtcc.com](mailto:mpozmanter@dtcc.com).

Sincerely,



Murray Pozmanter

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<sup>14</sup> See Consultative Document, page 19.

<sup>15</sup> See DTCC comment letter, page 3.