



07/31/2020

Via Electronic Submission

Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
fsb@fsb.org

Re: **Consultative document on Guidance on financial resources to support CCP resolution and on the treatment of CCP equity in resolution**

To Whom It May Concern:

Intercontinental Exchange, Inc., on behalf of itself and its subsidiaries (collectively, “ICE”) appreciates and welcomes the opportunity to comment on the Financial Stability Board’s (“FSB”) consultative document issued on May 4, 2020 entitled “Guidance on financial resources to support CCP resolution and on the treatment of CCP equity in resolution” (the “Consultation”).¹

ICE owns and operates six geographically diverse clearing houses serving global markets and customers across North America, Europe and Asia.² ICE has a successful history of clearing exchange traded and OTC derivatives across a spectrum of asset classes including energy, agriculture and financial products. As an operator of global clearing houses, ICE is keenly interested in the issues raised by the Consultation and appreciates the opportunity to comment.

Executive Summary:

ICE recognizes the importance of ensuring that adequate resources and tools are available in a resolution scenario to support the central counterparty’s (“CCP”) orderly resolution and to minimize adverse effects on financial stability. ICE appreciates the FSB’s continued engagement with international policy makers, regulators, CCPs and industry groups and is well positioned to provide a response to the issues raised by the questions set out in the Consultation. ICE has previously commented on various FSB discussion papers and consultative documents³ and appreciates the extent to which these comments have been reflected in the Consultation.

CCPs, together with their stakeholders and local regulators, have undertaken a substantial amount of work to enhance CCP resiliency, reducing systemic risk in the financial markets. Among other things, CCPs have established tools and recovery processes, including through their

¹ Financial Stability Board, Consultative document, Guidance on financial resources to support CCP resolution and on the treatment of CCP equity in resolution [hereafter, “Consultation”] (May 2020).

² The ICE clearing houses are ICE Clear Europe, ICE Clear US, ICE Clear Credit, ICE NGX Canada Inc., ICE Clear Singapore and ICE Clear Netherlands.

³ Please refer to ICE’s comments dated October, 17, 2016 to the FSB Discussion Note Concerning Essential Aspects of CCP Resolution Planning and ICE’s comments dated March 20, 2017 to the FSB’s consultative document concerning Guidance on Central Counterparty Resolution and Resolution Planning.

rulebooks, to provide for recovery under relevant law and in collaboration with their local authorities. CCPs' existing recovery procedures have been: (1) developed in consultation with the CCPs' clearing members and end-users; (2) formally agreed upon, by the clearing members pursuant to CCPs' rulebooks and member agreements and, where applicable, by customers pursuant to their clearing agreements; (3) reviewed and approved by CCPs' regulators; and, (4) incorporated in the CCPs' rulebooks for purposes of transparency and certainty. These recovery procedures are expected to manage most, if not all, difficulties faced by a CCP.

Key Points:

ICE summarizes its key points below for ease of reference:

- Local authorities are best suited to identify default and non-default loss scenarios, given they are most familiar with the CCP's legal framework and its unique attributes. To be effective, international guidance needs to allow local resolution authorities to undertake planning in a manner that is tailored to their legal frameworks and CCPs. International guidance that is too prescriptive, as ICE believes the Consultation proposes, could be inconsistent with and undermine the legislation and regulation to which local authorities of CCPs are bound.
- Given the robust framework established by international policy makers to promote CCP resiliency, ICE encourages the FSB to consider whether the guidance in the Consultation is necessary, especially if such guidance may conflict with local implementation of existing standards that support recovery over resolution. To the extent that the FSB decides to move forward with the guidance outlined in the Consultation, ICE recommends that any resolution actions be prescribed ex ante in the CCP's rules.
- The Consultation identifies granular and implausible default and non-default scenarios that presume early intervention and an inability of the CCP to use its recovery tools and resources. The extreme and implausible nature of some of the scenarios does not reconcile with current international standards that focus on actions a local resolution authority must take as a part of resolution planning.
- ICE does not support mandating equity be set aside for resolution or reimbursing clearing members for financial resources contributed in resolution. Making additional equity available based on these scenarios could create incentives for resolution over recovery and undermine the carefully designed incentive structure at CCP that are currently in place, increasing rather than facilitating the goal of reducing systemic risk.
- CCPs should not be responsible for certain non-default losses where CCPs are not in control of the risk, as in the case of custody and settlement risk from a defaulting commercial custodian or settlement bank. For example, in the case of custody and settlement risk from a defaulting custodian or settlement bank, although a CCP may have policies and procedures designed to mitigate such risk, the possibility of a custodian or settlement bank failure cannot be completely eliminated and is outside the control of the CCP. In such a situation, a CCP should not be obligated to guarantee or backstop the liabilities of a failed custodian or settlement bank.

- ICE supports CCP access to central bank accounts and urges the FSB to assist CCPs in gaining access to central bank accounts in order to reduce systemic risk and regulatory arbitrage.

Resolution Authority Actions Should be Agreed Ex Ante and Defined in Rulebooks

ICE emphasizes the importance of agreeing ex ante and defining in CCP rulebooks the tools that will be used in the event of a CCP's recovery or resolution. Resolution authorities should have the power to compel a CCP to incorporate the appropriate tools in its rulebook as part of recovery and resolution planning. However, once a CCP encounters a market stress event, ICE believes it is critical that the actions taken by the resolution authority must be in accordance with the CCP's rules and arrangements agreed upon ex ante. If resolution authorities are entitled or incentivized to interfere with, or override, a CCP's pre-agreed recovery process or otherwise act in a manner that is inconsistent with a CCP's rules, it will create uncertainty and instability in the market, impact members' regulatory capital requirements by creating the potential for unlimited liability, and undermine the well-designed incentives during a recovery and resolution.

More specifically, and for the reasons set out above, ICE does not support granting the resolution authority distinct, statutory powers to make cash calls that go beyond the CCP's rules (as indicated in paragraphs 5.2 of the Consultation). To the extent the FSB concludes that such powers should be available, we strongly support the Consultation's indication that any such statutory power be subject to a specific, ex ante statutory limit. Without a specific ex ante statutory limit, such powers could subject members to unlimited liability for regulatory capital purposes and would create market uncertainty and mis-incentives in a crisis scenario.

Scenarios

ICE believes that the scenarios presented in the Consultation are in some cases implausible in nature and 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 a CCP's financial resources are sufficient. Specifically, ICE believes that the scenarios included in the Consultation inappropriately assume that: 1) the CCP will not be able to use its recovery tools and resources; 2) the shareholders will not support CCP's recovery actions and 3) that the CCP equity should bear non-default losses. ICE believes that resolution is to be invoked only in a situation where all efforts at recovery have been unsuccessful and strongly discourages scenarios that presume early intervention, and that local authorities should maintain sole discretion for defining the scenarios considered in resolution planning.

Treatment of CCP Equity in Resolution

ICE has significant concerns that the guidance in the Consultation that CCPs make available equity for resolution or for reimbursing clearing members for financial resources contributed in resolution would undermine the carefully designed incentive structures at CCP currently. More specifically, adjusting the treatment of CCP equity in resolution could undermine

and substantially weaken clearing participants' incentives to commit to the recovery phase, increasing the likelihood that a CCP would end up in resolution. Currently, the incentive structures at CCPs are designed to manage a clearing member default or a CCP recovery and, as a consequence, CCPs and clearing members are highly incentivized to participate in the default management or resolution process because failure to participate creates a risk of a greater loss. By contrast, allocating equity to the clearing members effectively creates an ownership opportunity for clearing members in a market stress event that could skew the incentive structure supporting a CCP's default management and recovery process. Specifically, if a CCP is approaching resolution, clearing members will likely have suffered losses under the default management process. If bearing a relatively small amount of additional losses would result in an ownership stake in the CCP, there is a risk that clearing members would view it as more beneficial to artificially limit their participation in the default management process and encourage the resolution of the CCP to gain this ownership. Any compensation at the end of a resolution process must be designed to preserve crucial incentives for clearing members to participate in default management and support CCP recovery.

In addition, any FSB guidance needs to be conscious that awarding equity may upset CCPs' structure, which is established to provide that independent owners, clearing participants (through the risk committee), and CCP senior management are all incentivized to manage overall risk effectively. When a CCP clears multiple asset classes with unique clearing memberships, providing an equity stake to one class of clearing members and not others would, at a minimum, be extremely complicated. For example, if defaults only occurred for certain asset classes and clearing members in these asset classes were provided an equity interest in the entire CCP structure, it could threaten the security of clearing members of other asset classes.

ICE notes that CCP owners are already liable for significant losses through amounts agreed ex ante and pre-funded in the default fund. CCP owners contribute to default funds in a commercially appropriate amount to enhance confidence in the CCP's provision of service and which, at a minimum, meet any relevant regulatory requirements. A CCP's regulatory capital requirements are established and overseen by its supervisory authority and it is critical that once a CCP enters resolution, equity only be written down after rulebook resources and tools have been exhausted. If, equity is written down by a resolution authority, the CCP could be in breach of its regulatory capital requirements.

Finally, if equity is to be awarded, ICE believes recommends the following sequence should be followed:

- (a) all loss allocation measures and recoveries from defaulting counterparties have been applied;
- (b) the CCP's owners are unwilling or unable to recapitalize the CCP; and
- (c) existing equity has been written down.

Non-Default Loss Allocation

ICE believes that the allocation of non-default losses should depend on the nature of the loss. ICE acknowledges that there are some non-default loss events where control rests mainly with the CCP; in these cases, ICE believes the responsibility for funding these losses should also rest with the CCP. On the other hand, where non-default losses are not within a CCP's control, ICE does not believe it is appropriate for the CCP to be responsible for such losses. For example, where non-default losses are associated with the custody and settlement risk from a defaulting commercial custodian or settlement bank, non-default losses should be handled in a manner consistent with market practice in those areas of financial services. A CCP may be compelled to use a commercial bank for its settlement processes, either because the central bank does not maintain accounts for such entities or because the settlement is in a foreign currency. In such a case, where a CCP's services may only be offered using the services of commercial banks, ICE believes that it is appropriate to mutualize any loss on settlement bank default. Further, custodians and clearing brokers for example disclaim liability for their usage of other legal entities via sub-custodial or depository relationships as a matter of practice.⁴ In instances where other entities share responsibility for the non-default losses, it should not be the case that a full write down of CCP equity is required before calling funds from beyond the CCP.

CCPs Facilitate Market Participation by Managing Liquidity Risk

CCPs manage a significant amount of collateral largely in the form of cash and government securities. The management of these large collateral balances and the need to facilitate daily variation margining requires the mitigation of custodial and depository risk and collateral liquidity risk. While clearing houses have successfully managed these risks in the past through commercial arrangements, such arrangements are frequently with institutions that are also clearing members. Unfortunately, the arrangements cannot always scale with market activity and leaves CCPs searching for additional capacity to secure such collateral during times of market stress. Central banks can eliminate custodial and depository risk by allowing CCPs access to deposit the local currency in a central bank account and eliminate liquidity risk by granting CCPs access to the central bank for the limited purpose of transforming government securities into the local currency. Central bank access benefits the market, reduces depository,

⁴ An example of commonly used disclaimer language in a custodial agreement is as follows: "In the performance of its duties hereunder, the Custodian shall exercise the reasonable care, prudence and diligence expected of a professional custodian that is a bank or trust company and having professional expertise in financial and securities processing transactions and custody and shall act in good faith in the performance of its duties hereunder (the "Standard of Care"); provided that Custodian shall not be liable for any and all loss, costs, damage, expenses, damages, liabilities or claims, including attorneys' and accountants' fees and expenses (collectively, "Losses"), incurred by or asserted against Custodian, except those Losses arising out of the negligence, fraud, recklessness or willful misconduct of Custodian. Custodian will not be liable for loss of profits, indirect, consequential, incidental, punitive or special damages, even if Custodian has been advised of the possibility or likelihood of such damages."



operational and investment risk and has proven to be a useful tool, allowing designated CCPs to more safely and soundly secure collateral, including client funds. ICE urges the FSB to assist CCPs with gaining access to central bank accounts.

Conclusion

ICE welcomes the ongoing involvement of the FSB and its members in the important topics of clearing house recovery, resolution and resilience. ICE believes that the Consultation raises significant questions concerning the operation of resolution proceedings that warrant further consideration and discussion among clearing houses, their participants and users, regulators and other interested stakeholders. To the extent the FSB decides to move forward with the Consultation, ICE recommends any additional guidance by the FSB not conflict with CCPs' policies and procedures currently in place or local authorities' powers to design and apply regulatory requirements that are appropriate for their local CCPs.

Sincerely,

Chris Edmonds

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Intercontinental Exchange, Inc.