

Guidance on Central Counterparty Resolution and Resolution Planning

Overview of responses to the public consultation

On 1 February 2017, the FSB published a consultative document on *Guidance on Central Counterparty Resolution and Resolution Planning* ('Guidance'). The FSB received 27 responses including from CCPs, clearing participants, industry associations and others.

Respondents generally supported the proposed Guidance as an important step towards addressing the financial disruption that could occur in the event that a CCP fails. Several respondents noted and welcomed that the FSB had taken on board a number of comments from responses to the August 2016 *Discussion Note Essential Aspects of CCP Resolution Planning*.

This note summarises the main points from the responses to the consultation, based on the sections of the Guidance.

1. Objectives of CCP resolution and resolution planning

Most respondents agreed with the objectives, with some small suggestions to add detail regarding: maintaining as well as restoring critical functions; maintaining incentives to support recovery; minimising exposure to public funds; and ensuring orderly loss mutualisation in accordance with CCP rules is not considered negative 'contagion'.

The final Guidance contains a number of small amendments to reflect these points, where they were not already covered in the Guidance.

2. Resolution authority and resolution powers

General comments

There was support that resolution authority powers should come from legislation, statutes and regulations; but equally that CCPs should not be prevented from using certain tools in recovery.

In general, the balance between transparency and flexibility was welcomed, though some would prefer more certainty and transparency, while others were concerned about the effect on recovery incentives if there were too much transparency and limited flexibility for resolution authority actions.

Enforcing contractual obligations

CCP respondents sought stronger statements asserting that resolution authorities should follow the recovery plan as far as possible. Some commented that the extent and limits of the resolution authority's discretion should also be set out in the rules.

Tools to return to a matched book

There were a large number of comments, with an overall support for preferring partial tear up over full tear up and forced allocation, but only when other options such as auctions had clearly no prospect of succeeding. There were specific comments on maintaining client protections under segregation and portability arrangements; maintaining incentives; and acting quickly in crisis. There were requests for clarifying references to ‘last resort’ options which occurred in a number of places in the Guidance. Forced allocation was the least supported tool.

The Guidance already makes clear that a resolution authority should only consider tools such as partial tear up if the CCP’s own market based actions (e.g. auctions or direct liquidation of positions into the market) have failed or are expected to fail. The Guidance has been amended to state that forced allocation of positions should only be used by the resolution authority to re-establish a matched book where no other option would likely result in a better outcome for financial stability.

Powers to address outstanding default losses and replenish financial resources in a member-default loss scenario; and powers for non-default losses

A range of comments were received on this section both for and against the use of different tools and with different views on whom losses should or should not fall in resolution, most notably on variation margin gains haircutting. Some respondents felt there should be a single cap on exposures of clearing participants to the CCP across both recovery and resolution.

On initial margin, though some respondents welcomed the clarification that bankruptcy remote initial margin would not be haircut in resolution, they raised concerns that it might encourage members to post a higher proportion of non-cash collateral, which may have a negative impact on the CCP’s liquidity when required to manage a member default. Others continued to argue that it should not be permitted under any circumstances.

The Guidance has been updated for some clarifying amendments, but due to existing Guidance representing a balance of the wide range of views expressed there have been no substantive changes.

Equity in return for contributions to the CCP resolution

CCP respondents strongly rejected the idea of compensation with equity, noting that it would disincentivise participation in recovery and may distort ownership incentives, especially in multi-asset class CCPs or where some members are not permitted to hold the equity of CCPs.

Responses from clearing participants on the other hand strongly support receiving compensation, even for losses contemplated in recovery and under the CCP rules, arguing that creditor status is necessary to receive protections under the ‘no creditor worse off’ (NCWO) safeguard. Respondents either did not support or sought clarification on the Guidance relating to compensation in the form of claims on parents of CCPs.

The Guidance has been updated to refer more clear to compensation, which may include equity, rather than only to equity. It should be noted that the Guidance states authorities should have such powers, but this is not a requirement to provide compensation, and only where clearing members contribute financial resources to a resolution in excess of their obligations under the CCP’s rules and arrangements. This will be for relevant authorities to determine based on a number of factors including application of the NCWO safeguard.

3. Entry into resolution

General

On the timing of entry into resolution, some CCP respondents sought stronger expression that resolution should only commence when the recovery plan has been exhausted.

On transparency, the indicators were welcomed though some respondents (mainly participants) sought more specific guidance and others thought that there must be a high level of transparency. Others, primarily CCP respondents, noted that the exact trigger point had to take into account prevailing circumstances as well as market structure, and warned that too much rigidity could affect incentives to support recovery.

The Guidance already states clearly, in section 3.1, that a resolution authority should allow for recovery measures to proceed where they are reasonably likely to be effective within the timeframe required to meet the objectives of resolution. It also states that resolution should nevertheless be possible before all recovery measures have been exhausted, where specific conditions are met. These conditions will typically be established in the statutory framework supporting the resolution regime.

Specific indicators

The principles behind the indicators for both default and non-default were supported. The main comments regarding default loss indicators were that it was not clear what is meant by ‘committed resources’ in the Guidance, and that the ‘lack of confidence’ indicator was too vague and subjective, so should be amended or removed.

On non-default losses, there was concern that under the proposed wording a CCP could in theory be put into resolution for a minor or trivial breach of regulatory requirements.

The Guidance has been updated to remove references to lack of confidence as an indicator, and to make clear that it is failures to comply with regulatory requirements *that threaten financial stability*, that are potential indicators for resolution from non-default losses.

Co-ordination between authorities

Most responses stressed the need for clarity on the types of information required from CCPs, and that these should not impose additional system requirements for extremely unlikely events. Information exchange between authorities should be done in a manner consistent with the applicable laws and regulations that preserve confidentiality and anonymity.

Whilst these are important, the types of information and nature of exchange will depend on a number of factors including relating to the particular CCP and the markets it clears, and therefore is not specified in this Guidance.

The Guidance has been updated to reflect that, in some jurisdictions, a number of authorities together with (rather than in consultation with) the resolution authority may be required to make a decision regarding entry into resolution.

4. Allocating losses to equity holders in resolution

CCP respondents commented that the exercise of write down powers should only be contemplated when losses exceed those that can be absorbed under the CCP’s rules and arrangements, for both default and non-default losses. This was already stated in the

Guidance.

For default losses, CCP respondents commented that equity should not be written down until all rules based allocation have been fully exhausted and participants have met all obligations.

Participants (as expressed through industry association responses) had mixed views. Some members supported the removal of non-recourse provisions to ensure equity can bear losses beyond ‘skin-in-the-game’ contributions from the CCP or its owners (but product siloing provisions could be maintained); but other members did not believe CCP equity should necessarily be reducible to zero.

The issues of treatment of equity will be considered as part of the ongoing work on financial resources for CCP resolution.

5. No creditor worse off safeguard

General comments

Participants broadly supported the approach set out in the Guidance. CCP respondents, however, felt that the counterfactual should take into account additional costs that may arise in the event of a CCP’s failure, such as costs replacing positions in potentially stressed market conditions, establishing memberships/relationship with new CCPs, or requiring additional capital for non-centrally cleared trades.

Amongst other detailed comments, there was some concern about the possibility of departing from *pari passu* treatment of creditors. CCP respondents welcomed the recognition of benefits of limited recourse segregation between different services in a multi-asset class CCP.

Possible differences between resolution and the counterfactual

A number of respondents noted a possible inconsistency if the counterfactual assumes liquidation or termination only at a service level (for a multi-asset class CCP), whereas in practice an insolvency would affect a whole legal entity, not just individual services within it.

The Guidance has been updated to clarify that for the counterfactual, tear up and liquidation is assumed to take place at the same time as entry into resolution; and that the counterfactual should assume liquidation of the CCP’s legal entity.

6. Financial resources

General comments

There was support for the proposed additional work on financial resources. Some commented that additional financial resource requirements could distract from default management resilience and increase costs. One participant argued public money should be exposed to losses before client funds.

Provision and recovery of temporary funding

There were many comments on this section, seeking clarification on aspects such as the recovery mechanisms envisaged; the population of ‘market participants’ that might be required to contribute; and whether recovery amounts would be capped. Some CCPs argued this section should be removed as use of public funds should not be contemplated.

The Guidance makes clear that resolution planning should not rely on public solvency support and not create an expectation that such support will be available. Specific recovery mechanisms for temporary public funding will depend on part in local circumstances and legal regimes.

7. Resolution planning

Most comments on this section related to transparency and communication of the recovery plan. Broadly, participants strongly supported as much disclosure as possible to provide greater certainty in resolution, whereas CCPs cautioned regarding the impact on incentives of disclosing elements of the resolution plan. The current Guidance seeks to offer a balance between these two viewpoints.

8. Resolvability assessments and addressing impediments to resolvability

Participants strongly supported resolvability assessments and powers of resolution authorities to require changes to CCP rulebooks; whereas CCPs stressed that changes to address impediments to resolvability should not adversely impact the business as usual operations of a CCP and should be proportionate.

Detailed comments suggested the need for further work on the impact of interconnected especially interoperating CCPs; and that resolution authorities should be empowered to require critical service providers to continue performing obligations/ services for a CCP during a resolution. This latter point is already addressed by the FMI Annex to the *Key Attributes*; see section 11.6(iv).

9. Crisis Management Groups

There were few comments on the factors for assessing systemic importance or composition of CMGs. Some respondents noted that crisis management exercises are important to test arrangements including communications. On information sharing, some noted the importance of doing so in a manner consistent with the applicable laws and regulations that preserve confidentiality and anonymity.

10. Cross-border effectiveness and enforcement of resolution actions

Some respondents noted that the Guidance referred only to communicating with authorities responsible for clearing mandates, rather than act of suspension and should further guidance on whether this is an option on resolution.

Decision making regarding clearing mandates typically does not lie with resolution authorities, and there may be other situations or circumstances in which clearing mandates may need to be reviewed.