

BLACKROCK

Financial Stability Board

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Via email to fsb@bis.org

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BlackRock Response to the FSB Consultative Report on “Application of the Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions” (12 August 2013)

Dear Sirs,

BlackRock¹ welcomes the opportunity to respond to the Financial Stability Board (FSB) Consultative Report on “Application of the Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions” (the “Report”). Our response will focus principally on Part 1, Appendix I (resolution regimes for FMIs) and certain aspects of Appendix III (client asset protection in resolution). We are also limiting our response to those FMIs that are central counterparties (“CCPs”).

At the outset we note that BlackRock responded to the CPSS-IOSCO 2012 consultation on resolution and recovery of Financial Market Infrastructures (FMIs) and more recently provided its views on the CPSS-IOSCO Report on Recovery of FMIs.² As we indicated in our 2012 response to the consultation by CPSS-IOSCO and again most recently, we believe that the regulatory focus and goal should be rapid resolution of FMIs. We are concerned that the Report presumes that entry into resolution should occur only after attempts at recovery have been unsuccessful. Financial stability is best served by a regime that focuses on a rapid and complete winding-down of the failing CCP’s positions and a timely and orderly repayment of margin monies rather than trying to recover a failed or failing CCP.

We appreciate the opportunity to address and comment on the issues raised by the Report. We are prepared to assist the FSB in any way we can, and welcome continued dialogue on these important issues. Please contact any of the undersigned if you have comments or questions regarding BlackRock’s views.

¹ BlackRock is a leader in investment management, risk management and advisory services for institutional and retail clients worldwide. At 30 June 2013, BlackRock’s AUM was \$ 3.86 trillion (€2.96 trillion). Our client base ranges from sovereign wealth funds and official institutions to financial institutions, foundations, corporations, charities and pension funds. The mainstay of our client base is represented by pensioners and savers. BlackRock pays due regards of its clients’ interests and it is from this perspective that we engage on all matters of public policy. BlackRock supports regulatory reform globally where it increases transparency, protects investors, facilitates responsible growth of capital markets and, based on thorough cost-benefit analyses, preserves consumer choice.

² Recovery of Financial Market Infrastructure, CPSS-IOSCO (11 October 2013), <http://www.blackrock.com/corporate/en-us/literature/publication/recovery-fmi-cpss-iosco-101113.pdf>; Recovery of Financial Market Infrastructure, CPSS-IOSCO (22 August 2013), <http://www.blackrock.com/corporate/en-us/literature/publication/fmi-recovery-cpss-iosco-082213.pdf>; Resolution and Recovery of Financial Market Infrastructure, CPSS-IOSCO (28 September 2012), <http://www.blackrock.com/corporate/en-us/literature/whitepaper/recovery-and-resolution-of-financial-market-infrastructures-cpss-iosco.pdf>

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BlackRock Response

Resolution of financial market infrastructure (FMI) –Consultative Report August 2013

1. All FMI's, including CCPs, should be sufficiently capitalized so as to avoid failure, and where failure is not avoidable, to fail without causing systemic risk. The overall regulatory goal should be to reduce the likelihood of a CCP needing to be resolved, but if resolution is necessary, to minimize losses in resolution.
2. Financial stability is best served by a regime that focuses on a rapid and complete winding-down of the failing CCP's positions and a timely and orderly repayment of margin monies rather than trying to recover a failed or failing CCP. We do not believe that maintaining the continuity of services by any one CCP is critical to avoiding the next financial crisis.
3. Appendix I, Paragraph 4.8 of the Report sets out certain proposed powers for resolution authorities. We agree that these powers, with relevant safeguards, should include the authority to (i) write down equity in the CCP; (ii) write down or convert to equity ("bail in") any outstanding debt of the CCP; (iii) enforce outstanding contractual obligations of clearing members to meet cash calls or make further contributions to a guarantee or default fund and (iv) terminate ("tear up") contracts. We do not agree that these powers (whether contained in the loss allocation rules and procedures of the CCP or independently obtained by the resolution authority) should include the authority to (i) reduce ("haircut") the value of any variation margin payable by the CCP to participants or (ii) write down initial margin provided by customers.
4. We believe that the use of customer margin for loss absorbency is antithetical to the goals of the G-20. As we understand it, the purpose of central clearing is to reduce systemic risk and to protect end-users. End-users are pension funds, retirement, insurance and other saving vehicles of hundreds of thousands of individuals. Official sanctioning of the use of customer collateral to prop up a failing CCP will impose losses on these "saver-taxpayers" and runs counter to the objectives of central clearing. Further, in those jurisdictions where swaps clearing is mandated, end-users may, consequently, decide to minimize their use of - or avoid transacting altogether in - resulting in significant reductions in the use of swaps and suboptimal risk management or no risk management at all.
5. CCPs should be required to increase their own capital to create a larger buffer against events, such as clearing member default, that could endanger the financial viability of a CCP. This will enforce and encourage robust risk management at the CCPs. This capital could take the form of additional equity or debt issuance structured to act as a bail-in layer of capital. We note that capital rules recently enacted by banking regulators will now require that banks hold capital against CCP exposure, an acknowledgement that CCP exposure is no longer considered zero RWA. These additional steps to capitalize a CCP will promote confidence with market participants that customer margin will not be required for loss absorption.
6. Haircutting collateral of indirect participants (customers of clearing members) unfairly imposes the costs of recovery and failed CCP risk management on entities that did not contribute to the losses or default and do not have the opportunity, access and/or ability to assess or significantly influence the risk management of the CCPs.
7. Recovery that includes the ability to haircut customer margin will be pro-cyclical, especially given the limited insight that indirect participants have into the financial health of the CCP. As soon as it appears that a CCP may be in difficulty, these customers will terminate their positions. Buyside firms, as fiduciaries for their clients, will act to preserve client assets, preferring to be "money good" rather than "position good".

8. Those market participants, such as clearing members and their affiliates, with superior information and earlier indications as to the financial condition of the CCP will exit sooner, increasing the probability that customers will end up with greater losses.
9. The purpose of the rapid liquidation of positions would be to close-out the clearing business very quickly and to return margin provided by non-defaulting clearing members and non-defaulting clients with minimum market loss. A rapid liquidation and return of margin would minimize end-user losses and would allow clearing members and their clients the option to establish replacement positions in the most efficient manner. This process is consistent with the principle of customer asset protection set out in Appendix III, Paragraph 1.1 (rapid return of customer assets and avoidance of adverse impacts from lack of access by customers to their assets).
10. It is important that liquidation be swift and orderly with ex ante defined procedures that are transparent to minimize the size of loss and provide certainty to participants of risk exposure and that they are money good. We support the provisions set out in Appendix I, Paragraph 12 that CCPs should be required to maintain information systems and controls that can promptly produce, both in normal times and during resolution, the relevant data and information needed to facilitate the implementation of resolution measures.
11. Immediately after a default where a CCP does not have the financial resources to sustain itself, the CCP will be risk neutral with a matched book, except for defaulted positions. A parallel process of tearing up matched positions, which is likely the majority of the portfolio, and holding an auction for unmatched positions should be implemented at that time. The “tear up” price must be established immediately as delay will increase volatility and losses. We also recommend that auction participants should be expanded to include clearing members as well as other market participants who are judged able to honour their bids. A larger number of auction participants and open participation would result in a more transparent process and result in a more fair and accurate market price.
12. CCPs should have resolution plans that are periodically reviewed and updated to reflect changes (if any) in relevant insolvency regimes. Resolution plans should also be periodically reviewed to assure that the plan takes into account current market practices to minimize operational risk in resolution implementation.
13. Appendix III, Paragraph 3 proposes to grant resolution authorities the power to transfer customer assets and corresponding contracts to a “qualified transferee” as an alternative to returning the assets to the customer—without requiring customer consent. We believe that a transfer of positions or the use of a transferee CCP to provide clearing services is as a practical matter illusory and will be harmful to end-users. We note that currently there is no fungibility of contracts and no process for portability of positions between CCPs. Further, a transfer without client consent appears to directly contrast with the principle stated in Appendix III, Paragraph 1.1 for rapid return of customer assets and avoidance of adverse impacts from lack of access to these assets.
14. We support the provisions in Appendix III, Paragraph 8 that firms should be required to maintain information systems and controls that can promptly produce, both in normal times and during resolution, the information necessary to effect the rapid return of customer assets and that such information should be kept in a format that is understandable to a third party. We believe that these record keeping requirements should be imposed on CCPs, clearing members and CCP/clearing member service providers, such as custodians.
15. BlackRock believes that insolvency regimes or other impediments to customer asset protection, such as those regimes that perpetuate “fellow customer” risk for cleared derivatives should be modified to eliminate any impediments, and that regulatory authorities should make these modifications (or seek legislative change) as a top priority.