Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: Consultative Document, *Application of the Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institution*

Dear Sirs and Mesdames:

The Clearing House Association L.L.C. ("Association") and The Clearing House Payments Company L.L.C. ("PaymentsCo" and, together with the Association, "The Clearing House")[1] appreciate the opportunity to provide comments to the Financial Stability Board ("FSB") on its consultative document, *Application of the Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions* ("Consultative Document"), and specifically to Appendix I of the Consultative Document dealing with the resolution of FMIs and systemically important FMI participants. This Consultative Document comes at the same time as the consultative report issued by the Committee on Payment and Settlement Systems ("CPSS") and the Board of the International Organization of Securities Commissions ("IOSCO") on the recovery of FMIs, which is itself a follow-up to CPSS and IOSCO's earlier consultative paper on recovery and resolution of FMIs, which was released last year as an attempt to "outline the features of effective recovery and resolution regimes for FMIs in accordance with the *Key Attributes* and consistent with the principles of supervision and oversight that apply to them."[2]

This letter will not attempt a comprehensive exploration of all aspects of the resolution of all kinds of FMIs, nor will we attempt to analyze these issues from different

[1] Established in 1853, The Clearing House Association L.L.C. is the nation's oldest banking association and payments company. It is owned by the world's largest commercial banks, which collectively employ 1.4 million people in the United States and hold more than half of all U.S. deposits. The Association is a nonpartisan advocacy organization representing through regulatory comment letters, *amicus* briefs, and white papers the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated-clearing-house, funds-transfer, and check-image payments made in the U.S. *See* The Clearing House's web page at http://www.theclearinghouse.org for additional information.

[2] CPSS-IOSCO, *Recovery and Resolution of Financial Market Infrastructures* at 1 (2012).

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points of view (e.g., participants in CCP-type systems); rather we will address the portions of the Consultative Document that apply to systemically important payment systems ("SIPS") from the view of a SIPS operator. Our comments are informed by our more than 40 years' experience in operating a large-value funds-transfer system. The Clearing House Interbank Payments System ("CHIPS") has been in operation since 1970 and currently processes more than $1.5 trillion (U.S.) in payments on an average day. The Clearing House pioneered many of the techniques that later became standard risk-mitigation procedures for SIPS, including bilateral credit limits, sender net debit caps, and collateralized loss-sharing agreements. Moreover, CHIPS has been in compliance with the CPSS's *Core Principles for Systemically Important Payment Systems* ("Core Principles") since their adoption in 2001, as it was in compliance with the "Lamfalussy Standards" when they were adopted in 1990. We therefore have considerable experience not only in operating a SIPS, but in meeting all applicable standards for the safe and sound operation of such a system.

Last year, PaymentsCo was designated a systemically important financial market utility by the Financial Stability Oversight Council ("FSOC") under Title VIII or the Dodd-Frank Wall Street Reform and Consumer Protection Act because of its operation of CHIPS.[3] As such PaymentsCo is subject to regulation of by the Board of Governors of the Federal Reserve System. As section 805(a)(1) of the Dodd-Frank Act states that the Federal Reserve Board shall take into consideration "relevant international standards" in prescribing risk-management standards,[4] The Clearing House has a keen interest the outcome of this standards-setting process.

SUMMARY

1. Resolution of FMIs.

- Troubled FMIs should not be placed into extraordinary resolution automatically. Extraordinary resolution is appropriate only for *financially troubled* FMIs whose resolution in ordinary bankruptcy or receivership would threaten financial stability.
- Different types of FMIs require different types of resolution powers. Distinctions should be made between trade repositories, which merely record and store data, and FMIs that process transactions. A further distinction should be made between FMIs that actually become parties to the transactions they process and those that do not.
- Owners of FMIs should not be required to pay in additional capital beyond what they have agreed to in advance.

[3] Financial Stability Oversight Council, *2012 Annual Report* at 146-51.

[4] 12 U.S.C. § 5464(a)(1).

2. Relationship to SIFI resolution

- If FMIs are expected to continue to provide services to a SIFI in resolution, it must be assured that the SIFI will be able to continue to meet its obligations to the FMI and its participants and will have access to central bank services and liquidity facilities if these are necessary to continue to meet those obligations.

DETAILED COMMENTS

## 1. Resolution of FMIs

### (a) General eligibility for resolution. Troubled FMIs should not be placed into extraordinary resolution automatically. Extraordinary resolution is appropriate only for financially troubled FMIs whose resolution in ordinary bankruptcy or receivership would threaten financial stability.

The Consultative Document states that FMIs should be subject to resolution[5] "in a manner appropriate to the FMIs and their critical role in financial markets."[6] "The presumption is that all FMIs are systemically important or critical, at least in the jurisdiction where they are located, typically because of their critical roles in the markets they serve," although an authority may determine that an FMI is not systemically important or critical and therefore not subject to resolution.[7]

The stark statement that all FMIs (unless specifically found to be not systemically important) must be resolved in accordance with the bank-like extraordinary resolution regimes as set out in the Key Attributes goes too far. No company should be put into extraordinary resolution unless the stakes are so high that the company's failure would jeopardize the stability of key markets. For example, in the United States an FMI might be designated as systemically important under Title VIII of the Dodd Frank Act, but that does not automatically qualify it for orderly liquidation under Title II. For that to take place, the Secretary of the Treasury would have to certify, *inter alia*, that:

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[5] The Consultative Document does not define *resolution* but following on the description of resolution regimes in *Key Attributes of Effective Resolution Regimes for Financial Institutions* ("Key Attributes") it appears that *resolution* is intended to refer to extraordinary regimes for resolving systemically important institutions outside of the normal bankruptcy or receivership procedures. The U.S. equivalent would be the orderly liquidation authority provided for under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

[6] Consultative Document at 15.

[7] *Id*.

> (1) the financial company is in danger of default;
>
> (2) the failure of the financial company and its resolution under otherwise applicable Federal or State law would have serious adverse effects on financial stability in the United States; [and]
>
> (3) no viable private sector alternative is available to prevent the default of the financial company . . . .[8]

We believe that the more nuanced approach of Title II is preferable to the stark all-FMIs-in-resolution formula of the Consultative Document. Resolution is a procedure that allows the resolution authority to take unusual measures to ensure that the resolved institution is able to continue operating. It exists because the threats to financial stability that would arise from the institution's failure would be so catastrophic that the institution simply cannot be allowed to fail in the ordinary manner. It follows that it should not be used unless there is absolutely no alternative, e.g., no equivalent FMI that can pick up the failed FMI's transactions, or no possibility that a successor FMI could be organized during the period during which the failed FMI would wind down its operations.

We also believe that it should be clear that resolution is appropriate to address only the *financial* viability of the FMI—resolution is not well-suited to address operational difficulties that could threaten an FMI. In other words, resolution should only be undertaken when there is a problem that can be solved by resolution. Operational problems, such as a breakdown of computer services caused by a cyber-attack, will not generally be solvable by the tools that will be available to resolution authorities.

**(b) Relationship between resolution and recovery**

There should be a clear demarcation between FMI recovery and resolution. In particular, the criteria for entry of the FMI into resolution should be clearly defined (see above) as well as a designation of who should pull the trigger. Although rapid decision-making may be necessary, it should be recognized that too-early intervention by the resolution authorities could disrupt market confidence and the expectations of participants.

**(c) Objectives of resolution of FMIs**

[8] 12 U.S.C. § 5383(b).

We agree with the objectives for resolution set out in the Consultative Document—continuity of timely completion of critical payment, clearing, settlement, and recording functions without exposing taxpayers to loss from solvency support.[9]

**(d) Different types of FMIs require different types of resolution powers. Distinctions should be made between trade repositories, which merely record and store data, and FMIs that process transactions. A further distinction should be made between FMIs that actually become parties to the transactions they process and those that do not.**

We agree with the statement that "[t]he choice of resolution powers that are applied to an FMI should take into account the types of critical functions that the FMI provides."[10] This is a critical point because FMIs are very diverse in their operations and forms of organization.

It is generally recognized that trade repositories ("TRs") are different from other FMIs in that they do not actually conduct transactions—they merely record, store, and update data about financial transactions conducted by others. A similar distinction should also be made between FMIs that merely process financial transactions but do not actually become a party to those transactions or themselves incur any financial obligations with respect to those transactions, and those FMIs that actually do take on those roles and responsibilities.

For example, CHIPS provides a service to banks that enables a CHIPS participant to send funds-transfer payment orders to another participant; CHIPS also provides a mechanism for automatically satisfying the sending participant's obligation to pay the amount of the order to the receiving participant. The prefunded balance account on the books of the Federal Reserve Bank of New York, which creates the medium through which settlement of CHIPS payment messages occurs, however, is not an asset of PaymentsCo,[11] and PaymentsCo has no financial obligation to any CHIPS participant in respect of any CHIPS payment message.

A system like CHIPS and an FMI like PaymentsCo may therefore have more in common with a TR than with an FMI that actually takes positions and incurs financial obligations in connection with the transactions it conducts. It follows that the tools that would be used by an authority resolving PaymentsCo or similar payment systems will be

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[9] Consultative Document at 15-16.

[10] *Id*. at 15.

[11] The CHIPS prefunded balance account is an obligation of FRBNY to all CHIPS funding participants, and PaymentsCo is merely the agent of the funding participants with exclusive authority to give instructions to FRBNY with respect to the account or any balance in the account. See CHIPS Rule 12(a)(2), available at http://www.chips.org/financials/operations/rulesDocs/073219.pdf.

more limited than those needed by an authority charged with resolving a central counterparty or similar FMI and could be limited to ensuring that the critical facilities remain available to participants for a limited time so that they can make alternative arrangements to clear and settle their payments.

**(e) Funding resolution. Owners of FMIs should not be required to pay in additional capital beyond what they have agreed to in advance.**

The Consultative Document states that jurisdictions should have in place arrangements to provide temporary funding to FMIs during resolution and be able to "recover any losses incurred by the State from shareholders, unsecured creditors (including FMI participants), or, if necessary, participants in the financial system more widely."[12]

We are opposed to any requirement that owners of FMIs must pay in additional capital over and above what they have agreed to in advance when they joined the FMI. In many cases the owners of an FMI will themselves be regulated financial institutions. In those cases their supervisors will as a matter of course condition their approval of the banks' investment in the FMI on there being limited liability with no mandatory capital calls. This is a basic safety and soundness principle for the regulator—any investment that a bank makes must be predictable and limited. Moreover voluntary contributions to fund an FMI in resolution may also be subject to the supervisor's approval, and thus the FMI may not be able to raise funds through this mechanism in an expeditious manner. While *ex ante* agreements to contribute funds up to agreed-upon limits may be a useful tool for funding an FMI in resolution, it is not clear that any bank supervisors would allow banks under their jurisdiction to enter into such agreements. Finally, it goes without saying that once the limits agreed to are reached, there can be no requirement for a bank to contribute additional funds to the FMI.

We do believe that an FMI's resolution plan should identify sources of funds that the FMI could appeal to if it needed additional funds.

**2. Relationship to SIFI resolution.**

**(a) If FMIs are expected to continue to provide services to a SIFI in resolution, it must be assured that the SIFI will be able to continue to meet its obligations to the FMI and its participants and will have access to central bank services and liquidity facilities if these are necessary to continue to meet those obligations.**

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[12] Consultative Document at 22.

Section II of the annex on FMIs deals with the resolution of systemically important FMI participants. A key part of this is that to support the critical functions of a participant in resolution, FMI rules should

> allow for a firm to maintain its participation as it undergoes a resolution process, subject to adequate safeguards to protect the continued safe and orderly operations of the FMI, including the condition that the firm continues to meet payment and delivery obligations and comply with any other obligations of participants under the rules of the FMI.[13]

We agree that this requirement is fine in principle, but if FMIs are going to be required to continue to provide services to a G-SIFI in resolution, they will have to satisfy their own risk-control and operational standards, and the ability of the G-SIFI continue to meet its obligations to the FMI and the remaining participants will be paramount and may require that the SIFI continue to have access to linked FMIs or central banks (including linked FMIs operated by central banks and central bank liquidity facilities) if that is necessary for the SIFI to meet these obligations.

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We hope that these comments have been helpful. If you have any questions about any matter discussed in this letter please contact me at 212-612-9234 or joe.alexander@theclearinghouse.org.

Very truly yours,

Joseph R. Alexander
Senior Vice President, Deputy
General Counsel, and Secretary

cc: Ms. Louise L. Roseman
Board of Governors of the Federal Reserve System

Mr. Jeffrey C. Marquardt
Board of Governors of the Federal Reserve System

[13] *Id*. at 27.

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