April 29, 2022

VIA ELECTRONIC SUBMISSION (fsb@fsb.org)
Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: The FSB, CPMI and IOSCO Report "Central Counterparty Financial Resources for Recovery and Resolution"

The Global Association of Central Counterparties ("CCP12") is the global association for CCPs, representing 41 members who operate over 60 individual central counterparties (CCPs) globally across the Americas, EMEA and the Asia-Pacific region.

CCP12 appreciates the opportunity to comment on the FSB, CPMI, and IOSCO Report "Central Counterparty Financial Resources for Recovery and Resolution"[1] ("the Report"). CCP12 previously contributed input[2] on the FSB's papers on "Key Attributes of Effective Resolution Regimes for Financial Institutions"[3], "Guidance on Central Counterparty Resolution and Resolution Planning"[4], "Financial resources to support CCP resolution and the treatment of CCP equity in resolution"[5], as well as on the more recent consultative document entitled "Guidance on financial resources to support CCP resolution and on the treatment of CCP equity in resolution"[6].

Generally, while we appreciate the work of international policymakers to develop standards that support the stability of the broader financial system, we do not believe that further work on CCP resources is necessary, which is affirmed by the results of the scenario analysis covered in the standard-setting bodies' Report. Its findings clearly demonstrate the resiliency of CCPs, particularly the participating CCPs, in navigating extreme stress events that were in many cases implausible.

The fact that stress events included in the scenario analysis for CCPs were extreme and implausible makes it even more questionable why further work would be necessary given the predominantly successful performance of CCPs in navigating the scenarios. Broadly, implausible scenarios should not be the basis for further work on CCP resources, since CCP resources are not meant to (nor should they) be sized to address implausible scenarios. The CPMI-IOSCO's *Principles for financial market infrastructures* ("PFMIs")[7] clearly set out that a CCP should maintain resources to address extreme but

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[1] FSB, CPMI and IOSCO Report "Central Counterparty Financial Resources for Recovery and Resolution" (March 2022), available at Link
[2] CCP12, Submissions, available at Link
[3] FSB, Key Attributes of Effective Resolution Regimes for Financial Institutions (October 2014), available at Link
[4] FSB, Guidance on Central Counterparty Resolution and Resolution Planning (July 2017), available at Link
[5] FSB, Discussion paper for public consultation, Financial resources to support CCP resolution and the treatment of CCP equity in resolution (November 2018), available at Link
[6] FSB, Consultative document, Guidance on financial resources to support CCP resolution and on the treatment of CCP equity in resolution (May 2020), available at Link
[7] CPMI, IOSCO, Principles for financial market infrastructures (April 20212), available at Link

plausible market conditions and have additional tools and/or resources to address losses that may arise in recovery (e.g., uncovered credit and liquidity shortfalls). Further, the highly unlikely nature of a resolution event mandates that policymakers apply a careful risk reward analysis when deciding appropriate capital and replenishment approaches for CCPs. Additionally, while we can appreciate that the Report's analysis did not focus on system-wide effects for both the default loss and non-default loss ("NDL") scenarios, we believe this was appropriately compensated for by the implausible nature of the scenarios.

Additionally, it is important to recognize that CCPs' other risk management practices greatly mitigate the likelihood of an event arising to a recovery event in the first place. CCPs have done a considerable amount of planning to prepare for the impact of various potential default and non-default scenarios over the years and CCPs' robustness demonstrated in the most recent challenging circumstances proves the work invested was well worth the effort and the tools and policies adopted by CCPs are effective and sufficient.

The need for further work is also not supported by the outcomes of the standard-setting bodies quantitative analysis of cash calls and variation margin gains haircutting ("VMGH"), which found that these tools had little impact on bank clearing members' liquidity, as noted in the analysis' findings. This was even the case when assuming maximum cash calls, 100% VMGH, and large haircuts to high quality liquid assets. The quantitative analysis further affirmed that cash calls and VMGH had low performance risk and are expected to be reliable.

We believe that the results of the Report's analysis indicate the resilience of CCPs and therefore lack of need for further work in this area. The introduction of novel "resources" including for instance the Total Loss-Absorbing Capacity ("TLAC") in CCPs, as often suggested by some market participants, cannot and should not be implemented by the CCP system.

The introduction of new or alternative styles of loss allocation to CCPs would fundamentally change the CCP's business model and balance sheets and make it a leveraged entity. That would force CCPs to increase their own funds in the default waterfall. The cost of clearing would rise, as CCPs would need to increase the capital dramatically and could undermine risk management incentives. CCPs' purpose is to mutualize risk, not to cover a significant portion of the risk of the clearing members. Covering such risk-taking would inappropriately undermine participants incentives to manage their risks, by severing the relationship between loss-bearing and risk-taking. CCPs should not be expected to underwrite the risk members bring into the system.

Broadly, CCPs have carefully designed their financial resources and tools, including those that make up the default waterfall, to support incentives for market participants to effectively manage their risks. These models have been successful, as has been demonstrated historically. The carefully calibrated incentives of the centrally clearing model further negate the need for any work that could result in inappropriate changes to loss bearing that undermine risk management incentives.

As to the two types of losses – default and non-default – we would like to present the following, more detailed remarks:

1) Default Losses

With respect to the default loss scenario, the Report rightfully cites that they were "intended to be significantly more severe than the 'extreme but plausible' standard set out in the PFMI" (pg. 5). Examining the assumptions of the Report's analysis, it is worth highlighting that the assumptions are implausible in nature – i.e., 1.4X multiplier to a given CCP's historical stress testing scenario, which already captures extreme but plausible market conditions and four largest clearing member groups' default.

That said, we welcome the FSB's finding revealing that "all the sampled CCPs would have had sufficient prefunded and recovery resources and tools to cover losses in the applied default loss scenarios" (pg. 20). In CCP12's opinion, it should be emphasized that this was the case despite the scenario's implausibility. In particular, seven of the fifteen CCP service lines fully addressed the potential default losses with only their prefunded financial resources. Of the eight CCP service lines that used tools beyond the mutualized default fund, six were able to address the losses using the recovery cash calls (or assessments), as set out in their rulebooks. Additionally, the analysis notes that for the one CCP that had to employ the use of both assessments and VMGH, at the individual bank clearing member level, the analysis "identified only limited impacts on their liquidity and solvency from the use" (pg. 3) of such tools.

Considering the extreme and implausible nature of the default loss scenario, it is even a more positive outcome that CCPs showed such strong resilience. While we acknowledge that there are limitations to the analysis as mentioned above, we appreciate that the FSB seems to share our view that CCPs' default-related recovery tools and resources are sufficient and that CCPs are very well equipped to deal with such extreme scenarios.

CCP12 is encouraged by the results of the Report which prove that the CCPs' resources and tools for managing defaults are sufficient to withstand not only extreme but plausible scenarios, but also extreme but implausible market stresses. This should lead to a logical conclusion that no further work is required in the area of default losses, other than vigilant monitoring and supervision performed by local supervisory authorities, which is already being effectively done on an on-going basis.

2) Non-Default Losses

While the Report characterizes the NDL scenarios as "common scenarios which were considered to be sufficiently severe," this is a mischaracterization, as they are in fact extreme and implausible. Broadly, the NDL scenarios assume the failure of the resolution regimes for banks (including global systemically important banks), which is troubling as the key objective of policymakers' work following the 2008 financial crisis was to provide for the continuity of banks critical services, including settlement and custody services. Additionally, the specific NDL scenarios included a number of implausible assumptions, as elaborated on below:

NDL Scenario 1

- The assumption considered in the first NDL scenario implausibly assumes that the following events could all occur simultaneously: i) a CCP loses access to the institution holding assets on behalf of the CCP that would cause the largest liquidity need to the CCP and the institution's affiliated clearing members default; ii) the two clearing members generating the largest payment obligation also default; and iii) funds deposited to a settlement bank also become inaccessible mid-settlement cycle. Notwithstanding the implausibility of these events occurring simultaneously, assumptions i) and ii) do not fairly recognize the resolution regime that is in place for banks, as noted above, and assumption iii) does not recognize the narrow timeframe in which funds are typically moved during a settlement cycle. Furthermore, this scenario, whether the three primary assumptions occur concurrently or independently, fails to recognize the risk management practices CCPs have in place to mitigate the likelihood of these events occurring in the first place, such as robust counterparty risk management practices.

- Despite the first NDL scenario's implausibility, all CCPs performed well and were able to address the liquidity needs without the complicating assumptions. With the first complicating assumption of this NDL scenario (i.e., the two clearing members generating the largest payment obligation also defaulted) and the second complicating assumption of this NDL scenario (i.e., funds deposited to a settlement bank become inaccessible mid-settlement cycle), all but one CCP had sufficient liquid resources and arrangements to manage the liquidity needs.

NDL Scenario 2

- The assumptions considered in the second NDL scenario implausibly assume that cash equaling the largest amount transferred on any day to a single depository was subject to cyber theft, which, depending on a CCP's cash management practice, requires that it assumes that multiple transfers throughout the day be subject to theft. This scenario does not allow for the basic assumption that if a CCP were to identify an issue earlier in the day with a given bank, such as theft of funds, the CCP would not continue to use such bank for further transfers throughout the day. Additionally, like the first NDL scenario, this scenario fails to recognize the risk management practices CCPs have in place to mitigate the likelihood of this scenario occurring, including cyber security protocols, account set-up and the use of controls (e.g., account agreements and distinct individuals performing set-up and approval functions), automation controls (e.g., SWIFT design), and daily settlement operations controls. Despite the fact that this scenario was implausible, given the reasons detailed above, two CCPs' prefunded and recovery resources were sufficient to address the scenario.

With the above in mind, CCPs strong resilience when confronting NDLs, as demonstrated in this analysis, is even more apparent. This positive outcome demonstrates CCPs' ability to navigate even extreme and implausible stress scenarios, further confirming our belief that CCPs' non-default related risk management practices, in addition to their recovery frameworks, are sufficient. Furthermore, given the implausibility of the NDL scenarios, we disagree with any reservations that the Report may note with regards to CCPs ability to withstand NDLs (e.g., findings relating to the second NDL scenario), as CCPs cannot and should not be expected to have tools and resources to address such implausible scenarios.

We would also like to stress that NDLs are very different and much more heterogenous as compared to default losses, and therefore require very different measures and management approaches. Non-default related risks should be primarily addressed with preventive policies and actions, as it is likely that adding more resources would not necessarily alleviate the problem. On the contrary, in cases such as theft, more funds available could mean greater losses, and in instances of cyber-attacks resulting in data or other non-financial losses, more resources would not address the issue. Therefore, the focus, especially of local supervisory authorities, should be on the design of effective tools to prevent NDLs, such as the most appropriate measures for protection against cyber risk or CCP access to central bank accounts to better secure collateral.

More broadly and as stated in our initial remarks, we do not believe that further work on CCPs' NDL resources is necessary. As affirmed by the results of the scenario analysis covered in the Report, the resiliency of CCPs, particularly the participating CCPs, in navigating the extreme and implausible NDL scenarios was clearly demonstrated.

Conclusion

While we do not believe further work is necessary, as outlined above, in the event continuing work on CCP financial resources for recovery and resolution is to be conducted, we stand by ready to provide our experience and expertise to ensure a mutual and in-depth understanding for the calibration of the scenarios and assumptions used.

As an overall matter, we encourage further 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. We believe such transparency would be useful to support CCPs and market participants in their ability to understand the expectations of the resolution authority with respect to the use of the CCP's wind-down strategy versus the anticipated timing of any intervention by the resolution authority. A lack of transparency poses the 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. Also, to the extent practicable, resolution authorities should disclose to the marketplace what they are considering in developing their resolution plans, which would help enable CCPs to measure, monitor and manage the expectations of their resolution authorities.

If the FSB and other standard-setting bodies do decide to continue work on CCP resources, it is of paramount importance that CCPs and local supervisory authorities are actively engaged in the analysis and exercises to guarantee that the CCPs' models, applied solutions, policies and fundamental roles are understood and tested most efficiently. Furthermore, the unique characteristics of different CCPs (e.g., products cleared) should also be considered, which would require engagement with CCPs. Along these lines, a previous FSB consultative document noted 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."[8]

[8] See FSB, Consultative document, Guidance on financial resources to support CCP resolution and on the treatment of CCP equity in resolution", *op. cit.*, page 6.

About CCP12

CCP12 is the global association for CCPs, representing 41 members who operate over 60 individual central counterparties (CCPs) globally across the Americas, EMEA and the Asia-Pacific region.

CCP12 promotes effective, practical, and appropriate risk management and operational standards for CCPs to ensure the safety and efficiency of the financial markets it represents. CCP12 leads and assesses global regulatory and industry initiatives that concern CCPs to form consensus views, while also actively engaging with regulatory agencies and industry constituents through consultation responses, forum discussions and position papers.

For more information, please contact the office by e-mail at office@ccp12.org or through our website by visiting www.ccp12.org.

CCP12 Members