

EACH response – FSB Consultation on Financial Resources and Tools for Central Counterparty Resolution – November 2023

Introduction

The European Association of CCP Clearing Houses (EACH) represents the interests of Central Counterparties (CCPs) in Europe since 1992. CCPs are financial market infrastructures that significantly contribute to safer, more efficient and transparent global financial markets. EACH currently has 19 members from 15 different European countries. EACH is registered in the European Union Transparency Register with number 36897011311-96.

EACH appreciates the opportunity to provide feedback to the FSB consultation paper on Financial Resources and Tools for Central Counterparty Resolution¹ (hereinafter called “The consultation”).

Section 2: Objectives for CCP resolution resources and tools

1. Are the four parameters for resolution-specific resources and tools sufficient to comprehensively support the objectives for CCP resolution?

- A. to provide sufficient loss absorption, CCP recapitalisation options and liquidity to give resolution authorities a reasonable opportunity to achieve a successful resolution in default loss (DL) and non-default loss (NDL) scenarios;**
- B. to be reliable and readily available in resolution;**
- C. to mitigate potential adverse effects on financial stability; and**
- D. to align incentives across recovery and resolution and achieve outcomes in resolution consistent with the Key Attributes, including by ensuring CCP equity remains in a first-loss position and by preserving incentives for market participants to participate in recovery and central clearing.**

EACH overall agrees with the four parameters for resolution-specific resources and tools. We commend the FSB for structuring their analysis around four parameters that cover the availability and readiness of resources as well as the effects that their use could have on the CCP participants and the whole market. We especially welcome the reference to the need to align incentives across recovery and resolution, given that an incorrect structure of the resolution phase could disincentivise CCP participants from actively contributing towards a successful recovery.

¹ <https://www.fsb.org/wp-content/uploads/P190923.pdf>

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We also fully agree with the objectives of CCP resolution being financial stability and the continuity of critical CCP functions without exposing taxpayers to risk of loss.

We would however like the FSB to consider that the European CCP industry was at first relatively confused with the scope and objective of this draft FSB Guidance given the previous FSB Guidance on the matter. We kindly suggest better clarifying how the different documents interact with each other such as the FSB Key Attributes (2014), FSB Guidance on CCP Resolution and Resolution Planning (2017) and Guidance on Financial Resources to Support CCP Resolution and on the Treatment of CCP Equity in Resolution (2020).

We would also like to underline the following key concepts to be taken into account when considering CCP resolution resources:

- **CCPs are not banks** – The differences between CCPs and banks range from their business objectives, the balance sheet, the way they perform risk management through to their supervisory architecture. CCPs play a very different role from banks, and therefore we would kindly recommend the FSB **not to take into consideration tools for banking resolution that would be inappropriate in the context of CCP resolution, such as bail-in bonds and total loss-absorbing capacity (TLAC) ratio** (*please see further details in our answers to the next questions*) and which have already been discarded in existing and effective CCP resolution regimes².
- **Preventive measures for NDLS** - Some non-default events such as a cyberattack are unlikely to be addressed with additional resources, but they should rather be **prevented through the application of ex-ante measures**, such as an appropriate cybersecurity policy, as detailed in the EACH response³ to the CPMI-IOSCO consultation "A discussion paper on central counterparty practices to address non default losses".

2. Are there any other parameters that should be considered?

No, we do not think that there are any other parameters that should be considered.

Section 3: Scope of analysis on resolution resources and tools

3. Are the resource and tool descriptions appropriate and clear in order to underpin the remaining analysis in the consultation report?

² EU CCP Recovery and Resolution regime: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R0023>

UK CCP Recovery and Resolution regime: <https://www.legislation.gov.uk/ukpga/2012/21/contents>

³ <https://eachccp.eu/wp-content/uploads/2022/10/EACH-respons e-CPMI-IOSCO-consultation-on-NDLS.pdf>

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While EACH Members believe that the resource and tool descriptions are generally appropriate and clear to underpin the remaining analysis in the consultation report, EACH would like to express strong concerns regarding in particular two of the identified resolution resources, which we do not consider suitable for CCPs as they would distort the CCPs' incentive structure on which its neutral risk management is based and prevent the access to clearing by increasing its cost:

- **Bail-in bonds** (including the possibility for TLAC) – EACH believes that requiring CCPs to issue bail-in-able debt would be disruptive as it could fundamentally **change the positive risk management features** which have made CCPs so stable. CCPs do not typically issue debt, and doing so would convert them into **leveraged institutions**, which we believe is not the right approach for CCPs or the desire of resolution authorities.

In addition to the above, the following issues are identified with the consideration of bail-in bonds for CCPs:

- a) Decrease of incentives for adequate risk management** – It would force the CCP to increase the size of the default waterfall with its own capital. The costs of clearing would therefore increase while the **CCP would underwrite a greater portion of the risk, and substantially reduce any member or participants' incentives** to support the CCP beyond the point when this capital is used. As such, it would make the CCP similar to an insurance company for the part of the tail-risk of its members' portfolios and trades that this capital is guaranteeing. This would create strong pressures for CCPs to have smaller member-backed default funds.
- b) Alteration of loss-bearing** – The issuance of bail-in-able debt by a CCP would be an attempt to obtain a liability reduction at the expense of debt holders. The buyers of the debt would be exposed to the resolution of a CCP. If the buyers of the debt were not members of the CCP, the losses would be transmitted to participants outside the CCP and its participants. This would lead to contagion effects to financial institutions beyond the CCP and its participants, with an increased potential of negatively affecting financial stability. This does not support the CCP risk management standards of loss mutualisation. If on the other hand the buyers were the members of the CCP, then this would simply mean an extension of the waterfall, although the CCP would bear the running costs of the debt issuance.
- c) Unlevelled playing field with other jurisdictions** – The issuance of bail-in-able debt by CCPs would create an additional cost that would result in a competitive disadvantage for those CCPs in the jurisdictions where the issuance of bail-in-able debt would be applied. Clearing members might therefore decide to move to CCPs in jurisdictions where such tools are not applied. It is not in the interest of financial stability that market participants move to CCPs where they are less exposed to recovery and resolution costs.

In addition, the consultation report refers to the **TLAC**. Point 3(i) on bail-in bonds opens the possibility for the consideration of regulatory capital treatment for holdings of the bail-in bonds in order to disincentivise clearing participant and affiliate holdings, and makes a reference to the treatment prescribed in the Basel Committee on Banking Supervision's total loss-absorbing capacity⁴. As stated in our answer to Q1, CCPs are very different from banks. According to the PFMI⁵, CCPs collect margins from their members to cover their exposure and, if they are systemically important, maintain financial resources sufficient to cover the default of the two clearing members which would pose the highest credit risk to their clients and the CCP under extreme but plausible market conditions. The TLAC and minimum requirement for own funds and eligible liabilities (MREL) or any similar concepts are designed to provide **banking** resolution authorities with funds to stabilise **banks** during resolution. This approach is not appropriate for CCPs (including those with a banking license which do not perform the risk-taking activities of credit institutions)⁶. CCPs are risk managers that mutualise risk across their membership and have their own loss absorbing capacity: **the default waterfall**. A CCP's default waterfall comprises a set of prefunded lines of defence to be used in the event of a member default. As shown in Figure 1 these lines of defence are:

- Resources of the defaulting member (variation margin, initial margin, contribution of the defaulting member to the mutualised default fund);
- CCP's skin in the game;
- Contribution of non-defaulting members to the mutualised default fund;
- CCP's second skin in the game.

The default waterfall not only provides a substantial buffer of collateral to cover counterparty credit risk, but also ensures that the participants in the system have appropriate incentives to support an orderly default management process, as their default fund contribution is at risk.

Figure 1: CCP default waterfall

⁴ <https://www.bis.org/bcbs/publ/d387.pdf>

⁵ <https://www.bis.org/cpmi/publ/d101a.pdf>

⁶ <https://www.ecb.europa.eu/press/key/date/2015/html/sp150411.en.html>

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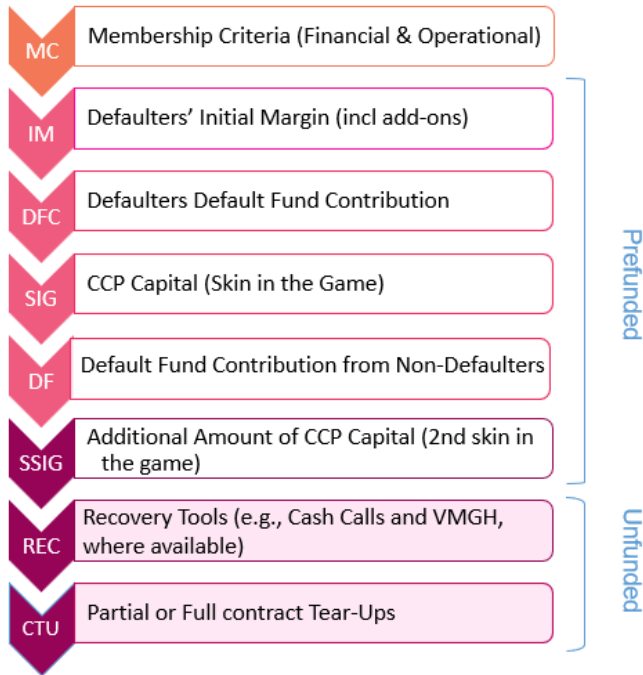
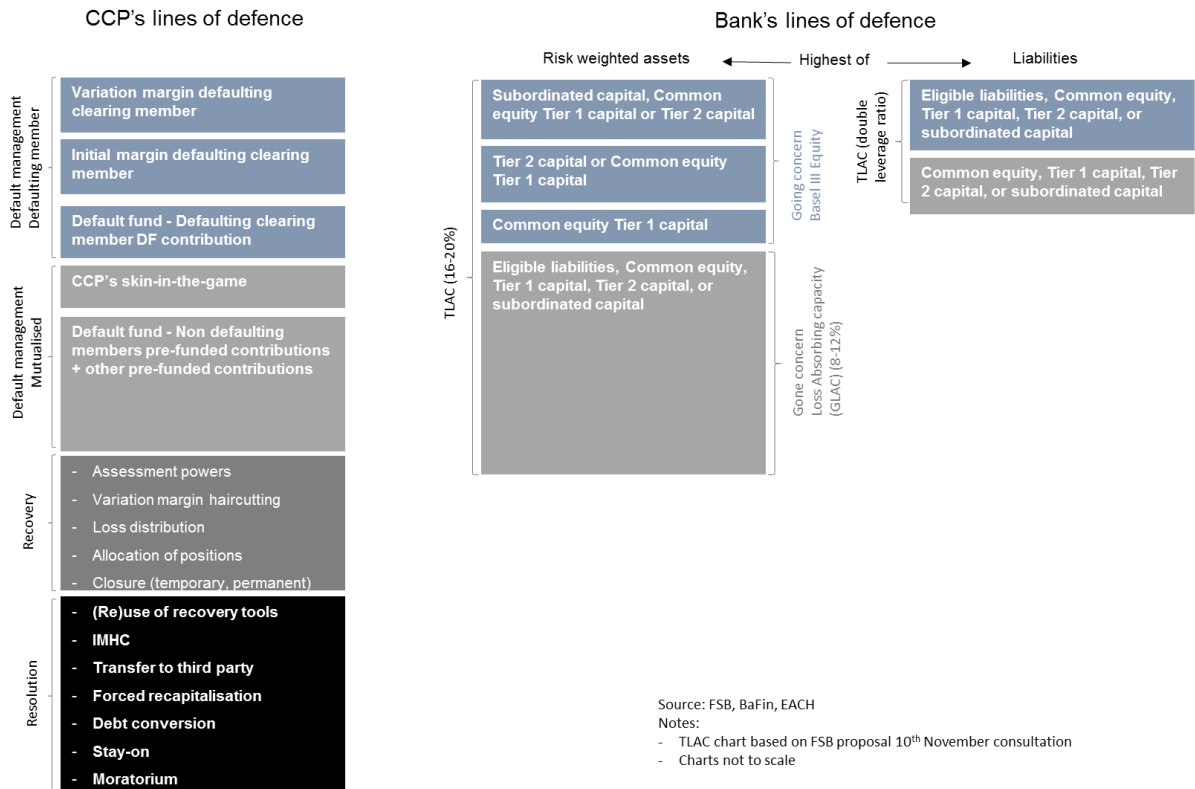


Figure 2 – Comparison of CCP's and Bank's lines of defence



Note: The Recovery and Resolution tools shown in Figure 2 are taken from the CPMI-IOSCO and FSB reports respectively. However, in practice the recovery tools may vary by CCP depending on the specificities of the products and markets served and the resolution tools may vary by jurisdiction.

The default waterfall structure described above provides CCPs, clearing members, clients and the market as a whole with a transparent, efficient and sound clearing infrastructure.

CCPs should be incentivised to provide prudent risk management to market participants and set the right incentives for clearing members to actively participate in the default management process following a member default.

A resolution regime which makes use of a TLAC-style tool does not fit within this framework as it could **undermine the effectiveness of the robust lines of defence and risk mutualisation structure** of the CCP.

- **Resolution funds** – A single resolution fund to be shared amongst all CCPs, similar to that developed for some EU banks, is not adequate for CCPs. **The concept of mutualisation of losses embedded in a single resolution fund is already central to the risk management framework of CCPs** through their default fund. The default fund acts as a mechanism for the mutualisation of the losses that arise from the management of a member default. For CCPs and their resolution authorities to be able to manage the incentives and allocation of losses, having a separate cross-CCP fund creates **confusion, complexity, and higher costs of clearing**. A single resolution fund for CCPs could **decrease the incentives for CCPs to develop and maintain adequate risk management procedures**. A single resolution fund for CCPs could reduce the focus on the default management process, which is at the core of the CCPs' role in the financial system. Creating a single resolution fund across CCPs could potentially increase confusion and dilute such incentives. This is a crucial feature to be considered in the context of resolution funds for CCPs, in addition to the costs for market participants associated with raising and maintaining such funds.

4. Are there other resolution-specific resources or tools that should be considered? If so, please describe the relevant resolution resource or tool, and how such resource or tool meets the parameters and dimensions. Alternatively, are there resources or tools that should be removed from consideration? If so, please explain why.

Yes, we consider there are additional resolution-specific tools that should be considered and others that should not. We describe them below.

Additional tools to be considered

We note that the FSB has not considered other tools included in existing resolution regimes such as the EU and UK ones notably some position and loss allocation tools such as **partial or full tear-up, sale of business tools and bridge CCP tool**⁷. We believe that any guidance for authorities to consider financial resources and tools for central counterparty resolution would

⁷ See II-Annex 1 of https://www.fsb.org/wp-content/uploads/r_141015.pdf and Article 27 of the EU CCP Recovery and Resolution legislation for an example: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R0023>

be incomplete without a reference to these tools, which are already referenced in previous FSB documents⁸.

Given the idea behind the FSB Guidance to act as toolbox for authorities and the non-prescriptive nature of the guidance which does not force the use of any particular tool, a failure to consider such tools would prove inadequate and could potentially mislead authorities that intend to apply resolution regimes. The FSB itself acknowledges in previous documents the need to consider the combination of these missing tools with the proposed ones or its independent use⁹.

We would also suggest the FSB Guidance make a reference to the potential for **accessing central bank facilities**. While this should be considered as a tool of last resource, given the extreme nature of CCP resolution, authorities may want to consider all options at hand, and this may be one. Some detailed analysis of access to central banks facilities by CCPs may be found in the IMF (2018)¹⁰ and EACH (2021)¹¹ documents.

Tools to be removed from consideration

Yes, as described in our response to question 3, we believe that bail-in bonds and resolution funds should be removed from consideration given their potential to increase financial stability risks.

Section 4: Qualitative analysis

5. The analysis identifies six key dimensions and maps them to the parameters for resolution-specific resources and tools. Are the descriptions of the dimensions sufficient? Are there other dimensions that should be considered?

We believe that the description of the dimensions is sufficient.

6. For each resolution-specific resource or tool discussed in the consultation report, have the key costs and benefits been appropriately identified? Are there additional cost/benefit factors that should be considered?

As explained in our response to Question 3, we consider **bail-in bonds and resolution funds as unsuitable resolution tools** for CCPs.

Resolution funds may be particularly challenging in jurisdictions like the EU with a single legislation rulebook but several fiscal regimes.

⁸ See the following document for an example: <https://www.fsb.org/wp-content/uploads/P090322.pdf>

⁹ <https://www.fsb.org/wp-content/uploads/P090322.pdf>

¹⁰ <https://www.elibrary.imf.org/view/journals/002/2018/227/article-A001-en.xml>

¹¹ <https://www.eachccp.eu/wp-content/uploads/2021/12/EACH-Note-on-CCP-access-to-Central-Banks-deposits-and-liquidity-December-2021.pdf>

We respectfully disagree with the suggestion that '*none of the parameters and their underlying analytical dimensions could be prioritised over others and instead all are essential in establishing an effective set of resolution resources and tools capable of addressing the various scenarios that could lead to resolution.*'.

7. Section 4.3 considers the parameters and dimensions necessary to support orderly resolution (e.g. without material adverse effect on financial stability) and to address the implications of the resources and tools on the CCP as a going concern and on clearing members and market participants. Does this section adequately capture the relevant considerations or are there other factors that should be considered, such as synergies, cost efficiencies or offsetting qualities?

EACH suggests that authorities consider different weights be given to different parameters and dimensions (e.g. costs or legal implications may weight more in the case of resolution fund).

8. Does the analysis by parameter and dimension provide sufficient clarity around how resources and tools may or may not contribute to a resolution toolbox such that the toolbox, in aggregate, would meet the parameters and dimensions?

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Section 5: Framework for resolution resources and tools

9. Is the toolbox approach and standard described a clear and effective means to support resolution objectives while providing flexibility to jurisdictions and resolution authorities?

The toolbox approach and standard described in the consultation paper represent a commendable framework for achieving resolution objectives while concurrently offering flexibility to jurisdictions and resolution authorities. This approach combines clarity and adaptability, creating a robust foundation for the resolution of CCPs.

The flexibility embedded in this approach and its non-prescriptive nature are particularly valuable. Recognising that the specific circumstances and regulatory landscapes of CCPs may vary across jurisdictions and that some already have in place effective resolution regimes. The toolbox approach allows for customisation within a standardised framework. This adaptability enables jurisdictions and resolution authorities to tailor their resolution strategies to suit their unique requirements while remaining aligned with global standards and principles.

The clarity inherent in the toolbox approach and standard is particularly beneficial. It provides a structured and comprehensive set of resources and tools that serve as a roadmap for resolution authorities and jurisdictions, improving preparedness and consistency in CCP resolution planning. This clarity helps to ensure that resolution objectives, such as loss

absorption, financial stability, and incentive alignment, are pursued with a clearly defined and common understanding.

10. Is the toolbox approach an effective means to achieve each of the four parameters outlined in Section 2?

- A. to provide sufficient loss absorption, CCP recapitalisation options and liquidity to give resolution authorities a reasonable opportunity to achieve a successful resolution in DL and NDL scenarios;**
- B. to be reliable and readily available in resolution;**
- C. to mitigate potential adverse effects on financial stability; and**
- D. to align incentives across recovery and resolution and achieve outcomes in resolution consistent with the Key Attributes, including by ensuring CCP equity remains in a first-loss position and by preserving incentives for market participants to participate in recovery and central clearing.**

We suggest that the final FSB guidance clearly highlights that due to the differences between the nature of default and non-default scenarios, not all tools are equally suitable in either case. This would be an important guidance for authorities to clearly note that for the fact of being part of the FSB report, not any tool is suitable for any scenario.

Furthermore, the proposed standards appear to focus primarily on financial risks as a cause of default losses (DLs) and non-default losses (NDLs). Therefore, we recommend that the final FSB report also considers the fact that operational risks may also be triggers for both DLs and NDLs. References to the ongoing FSB work on operational resilience would in this case be adequate¹².

11. With regard to sizing in each jurisdiction, should the standard specify potential approaches for calibrating the quantum of one or more resolution-specific resources and tools to support resolution?

It is prudent to acknowledge the robust and comprehensive framework already established within the European Union through the legislation on Central Counterparties Recovery and Resolution Regulation (CCP RRR). This framework includes a set of clearly defined measures and scenarios for the resolution of CCPs operating in EU jurisdictions.

Given the existence of the stringent EU framework, a global alignment with these measures and scenarios becomes not only practical but also essential. Harmonising the calibration of the quantum of resolution-specific resources and tools with the EU framework would not only enhance consistency but also facilitate efficient resolution planning for CCPs operating across multiple jurisdictions.

¹² See inclusion of 'Cyber and operational resilience' in FSB Work Programme 2023: <https://www.fsb.org/wp-content/uploads/PLEN202309REV2-FSB-Work-Programme-public-version-final.pdf>

While it is important to allow for some flexibility to accommodate specific regional considerations, a harmonised global approach ensures that CCPs, clearing members, and market participants benefit from a coherent and predictable resolution landscape. This approach promotes regulatory certainty and supports the resilience and stability of CCPs within a global financial context. Hence, EACH recommends that the proposed standards consider potential approaches for calibrating the quantum of resolution-specific resources and tools in alignment with the current comprehensive EU framework. This approach would facilitate global consistency while allowing for regional nuances, ultimately contributing to the effectiveness and resilience of CCP resolution mechanisms.

12. To what extent should the standard include transparency into jurisdictions' approaches to calibrating one or more of the resolution-specific resources and tools in the toolbox (such as a function or multiple of the default fund)?

We support the inclusion of transparency into jurisdictions' approaches to calibrating one or more of the resolution-specific resources and tools in the toolbox. Regarding the function or multiple of the default fund, we would like to stress that different tools and resources in the default management, recovery and resolution regimes serve different objectives and cannot be used as multipliers (e.g. the CCP's skin in the game serves mainly as an incentive for robust risk management and not mainly a loss absorbing tool as the default fund does).

13. What should be the scope of application for the standard? Should it apply to all systemically important CCPs or just to CCPs that are systemic in more than one jurisdiction?

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14. To what extent should jurisdictions' calibration analysis and choice of resolution-specific resources and tools in the toolbox take into account the home resolution authority's ability to (i) use resources and tools that are available to the CCP in recovery; and (ii) capability to intervene before they have been exhausted in recovery?

It is essential to consider two critical aspects when calibrating and choosing resolution-specific resources and tools within jurisdictions:

- 1. Use of Resources and Tools in Recovery:** As indicated in the consultation paper, it is important to recognise the home resolution authority's ability to make use of resources and tools that are already available to the CCP during its recovery phase. This approach ensures a well-functioning and coordinated transition from recovery to resolution, avoiding redundancy and ensuring that the measures used in both phases are coherent and aligned.
- 2. Early Intervention Capability:** Equally important is the home resolution authority's capability to intervene before resources and tools are fully exhausted during the recovery phase. This principle is enshrined in existing CCP Recovery and Resolution regimes such as Title IV of the EU one. Early intervention plays a crucial role in increasing the likelihood of

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a successful resolution by addressing issues proactively and preventing situations from escalating to the point where resolution becomes more challenging. This underlines the high importance of timely and well-informed decision-making by the resolution authority.

The role and capacity of the home resolution authority should be considered when calibrating and selecting resolution-specific resources and tools. This approach promotes efficiency, minimises duplication, and enhances the overall effectiveness of CCP resolution mechanisms. Moreover, the ability to intervene early in the process is a valuable tool in preserving financial stability and should be a central consideration when calibrating and selecting the resources and tools.

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