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November 20, 2023

Financial Stability Board  
Centralbahnplatz 2  
Basel CH-4002  
Switzerland

Re: *Financial Resources and Tools for Central Counterparty Resolution*

Dear Financial Stability Board Secretariat:

ICI Global<sup>1</sup> appreciates the opportunity to provide comments on the Financial Stability Board's (FSB) consultation on Financial Resources and Tools for Central Counterparty (CCP) Resolution.<sup>2</sup> Our members – regulated funds<sup>3</sup> in jurisdictions around the world – use centrally cleared products in a variety of ways to achieve their investment objectives in accordance with the terms of each fund's prospectus.<sup>4</sup>

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<sup>1</sup> ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated investment funds. With total assets of \$39.4 trillion, ICI's membership includes mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in Europe, Asia, and other jurisdictions. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. ICI Global has offices in Brussels, London, and Washington, DC.

<sup>2</sup> FSB, *Financial Resources and Tools for Central Counterparty Resolution: Consultation Report* (October 19, 2023) (the Consultation).

<sup>3</sup> For purposes of this letter, the term "regulated fund" refers to any fund that is organized, formed and regulated under national law, and is authorized for public sale. Such funds typically are subject to substantive regulation in areas such as disclosure, form of organization, custody, minimum capital, valuation, investment restrictions (*e.g.*, leverage, types of investments or "eligible assets," concentration limits and/or diversification standards). Examples of such funds include US investment companies regulated under the Investment Company Act of 1940 and EU UCITS.

<sup>4</sup> Derivatives, including those that are centrally cleared, offer regulated funds considerable flexibility in structuring their investment portfolios. These uses include hedging positions, equitizing cash that a regulated fund cannot immediately invest in direct security holdings, managing a regulated fund's cash position more generally, and adjusting duration.

We and our members have long supported efforts to enhance CCP resilience, recovery, and resolution.<sup>5</sup> CCPs play a critical role in the financial system and continuity of access to CCP services is essential to market participants, including regulated funds.

Overall, we support the toolbox approach in the Consultation and promoting its implementation as a global standard for CCP resolution resources and tools. International standards for the oversight of CCPs are essential because of the cross-border nature of markets for cleared products and the complexities arising from CCPs operating and being subject to oversight in multiple jurisdictions and by multiple authorities. A strong resolution regime can provide greater certainty to market participants, improve market confidence, and support the achievement of global post-crisis political commitments, including encouraging greater clearing of OTC derivatives and protection of customer collateral and funds.

We also support the standard's expectation that resolution authorities (i) have access to resolution-specific resources and tools and (ii) make transparent their approach to selecting and calibrating these tools; each of these expectations will enhance resolution regimes. If a resolution authority only has access to recovery tools, the authority's ability to successfully resolve a CCP may be limited in some scenarios, since authorities can only use recovery tools to the extent they are not exhausted in recovery. In a scenario where the recovery tools are exhausted and there are no resolution-specific tools, the authority could lack the necessary resources to resolve the CCP. In addition, as we discuss more fully in Section III below, it is critical that market participants, including regulated funds, understand how resolution tools would be used and their role in a CCP's resolution plan. When the resolution plan is transparent, and resources and tools are predictable – that is, they are measurable and manageable in advance – the resolution is more likely to be successful.

We support the resolution parameters that the FSB uses to analyze potential tools for inclusion in the toolbox. Consistent with these parameters, a guiding principle for the design and calibration of resolution tools, should be to allocate losses to the parties responsible for the losses and the CCP's failed risk management (*i.e.*, the CCP, equity holders, defaulting participants, and other clearing members) and not to non-defaulting customers. Under this principle, we support resolution tools that prioritize the protection of non-defaulting customers' assets rather than seeking to use them to cover losses attributable to the CCP or direct clearing participants, *i.e.*, refraining from appropriating non-defaulting customers' assets to cover losses in resolution. We encourage the FSB, as it continues its work, to add an additional resolution parameter that

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<sup>5</sup> See, e.g., ICI Global, [Letter from Patrice Bergé-Vincent to Secretariat to the Financial Stability Board, Re: Consultative Document – Guidance on Financial Resources to Support CCP Resolution and the Treatment of CCP Equity in Resolution \(July 29, 2020\) \(ICI Global's 2020 Letter\)](#); ICI Global, [Letter from Dan Waters to the Secretariat of the Financial Stability Board, Re: Guidance on Central Counterparty Resolution and Resolution Planning – Consultative Document \(March 13, 2017\)](#).

Notably, individual ICI members contributed to a 2020 industry whitepaper that provides specific recommendations from end-users and clearing members to enhance CCPs' resilience, recovery, and resolution. [A Path Forward for CCP Resilience, Recovery and Resolution \(March 10, 2020\) \(2020 Industry Whitepaper\)](#). Our comments on the Consultation are consistent with the principles and recommendations set forth in the 2020 Industry Whitepaper.

explicitly considers the impact of potential resolution resources and tools on non-defaulting customers. Non-defaulting customers have no control over the CCP's risk management and do not contribute to its distress in a default loss or non-default loss scenarios.

In contrast, we have strong concerns about including variation margin gains haircutting (VMGH) in the resolution toolbox. As discussed further below in Section II, this tool is inconsistent with the FSB's resolution parameters, essentially permitting resolution authorities to seize the assets of non-defaulting customers and use them to cover losses over which such customers have no control or contribution. In a default scenario, using these seized assets must be subject to strict limitations. Further, the tool is wholly inappropriate for use to address non-default losses (NDL) where the potential for adverse impacts is magnified.

In the remainder of our comments below, we provide more detail regarding: (1) the effectiveness of focusing the resolution toolbox on tools that allocate losses to responsible parties; (2) the reasons we discourage the inclusion of VMGH in the resolution toolbox and limitations that must be included if the tool is used; (3) why transparency is essential to the effectiveness of the toolkit approach; and (4) suggested measures to further enhance effectiveness of the FSB's proposed resolution resource standard, including steps to clarify when resolution is appropriate and the tools to be used in different loss scenarios.

### **I. An effective CCP resolution toolbox focuses on tools that allocate losses to responsible parties**

We strongly agree with the Consultation that effective resolution tools are consistent with the resolution parameters to the extent they would absorb losses and provide CCP recapitalization options and are reliable and readily available for use. Consistent with the FSB's parameters, a guiding principle for the design and calibration of resolution tools, should be to allocate losses to the parties responsible for the CCP's failed risk management and the losses – that is the CCP itself, its, equity holders, defaulting participants, and other clearing members. We appreciate that most of the tools the FSB proposes to include in the resolution toolbox appear to be consistent with this principle, based on the high-level descriptions in the Consultation.

We strongly agree with including equity and bail-in bonds in the resolution toolbox. These tools appropriately allocate losses to the CCP shareholders and bondholders and, as prefunded tools, they are reliable and ready for use. We caution that sizing of each of these tools is also a critical factor. A CCP must have material equity at stake, such that the potential risk of losing the equity can properly ensure robust risk management, particularly for for-profit CCPs.<sup>6</sup> The size of bail-in bonds is also important and must be large enough to provide authorities with sufficient resources to ensure continuity of clearing and effect a change in control of the resolved CCP as the bonds are 'bailed-in' and converted to equity.

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<sup>6</sup> Our members have previously suggested that regulators set CCP equity requirements as a significant percentage of their default funds, as the default fund serves as a proxy for the risk that the CCP manages. *See* 2020 Industry Whitepaper at 4. We support these recommendations.

For similar reasons, we support including resolution funds, resolution-specific insurance, and third-party contractual support in the toolbox, subject to our concerns around transparency as described in Section III below. Based on the high-level descriptions in the Consultation, these tools appear consistent with the resolution parameters and the principle of allocating losses to the parties responsible for the failed risk management. We encourage the FSB to clarify that these tools should be positioned adjacent to the CCP's equity (and any bail-in bond), particularly where the third-party is the CCP's parent company.

We also support resolution cash calls, which allocate losses to clearing members, who are responsible for the risk they assume and bring to the CCP. Resolution cash calls serve as an incentive for clearing members to ensure the adequacy of their risk management processes.

We also agree with the FSB that the list of tools in the Consultation may not be exhaustive, and over time, it may be appropriate for the FSB and resolution authorities to augment the toolbox. In doing so, we recommend that the FSB, preferably through an additional parameter, explicitly consider the potential for adverse effects on customers that may render tools and resources inadvisable for resolution. We further encourage the FSB and relevant authorities to continue quantitative work to determine the appropriate calibrations of resolution resources and tools and to make these results clear to market participants. As set forth in more detail in Section III, with the tools currently proposed to be included in the resolution toolbox, transparency around the use and calibration of these tools will be critical.

## **II. VMGH should not be included in the resolution toolbox without stringent limitations**

We note that the resolution toolkit does not clearly differentiate between resources and tools that resolution authorities should consider and use for default loss and NDL scenarios.<sup>7</sup> While many of the proposed resources and tools may be appropriate for both default loss and NDL scenarios, VMGH unquestionably is not. In a default loss scenario, this tool poses a serious risk to the non-defaulting customers of clearing members. If the resolution authorities use the tool to address default losses, such use must be subject to stringent limitations. In addition, VMGH is wholly inappropriate to address NDLs and should never be used for this purpose. We therefore cannot support the unqualified proposed inclusion of VMGH in the toolkit and, for the reasons set forth below, we strongly urge the FSB to discourage its use.<sup>8</sup>

### ***A. VMGH poses a serious risk to the non-defaulting customers of clearing members***

VMGH is a mechanism to transfer assets of non-defaulting customers to the CCP and its shareholders and enable a CCP to return to a matched book at the expense of the contract holder – which loses the rights that it had negotiated and paid for when the CCP accepted the contract

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<sup>7</sup> We further discuss the merits of differentiating tools for use in default loss and NDL scenarios in Section IV below.

<sup>8</sup> While not included in the Consultation, we noted that several participants in the FSB's recent outreach event suggested that contract tear-ups (CTU) be added to the toolkit. Our objections to including CTU are similar to those set forth here regarding VMGH. *See, e.g.*, ICI Global's 2020 Letter at 5-6.

for clearing. This tool involves seizing resources of non-defaulting customers, who are (often mandated) users of the CCP that play no meaningful role in, or have control over, CCP risk management, and have not contributed to the CCP's distress.

VMGH is inconsistent with the resolution parameters. This tool can create moral hazard, incentivizing CCPs and clearing members to take excessive risks – risks that potentially would not otherwise be taken if losses were not broadly allocated across end-users and only CCP and clearing member assets were at risk of loss in the event of failure. In anticipation of adverse outcomes in resolution, VMGH may incentivize clearing members and customers to liquidate trades, contributing to market destabilization and financial instability. Moreover, while the FSB states that VMGH would not impact CCPs' business models,<sup>9</sup> introducing risks that do not exist for regulated funds and other indirect customers when transacting in uncleared products, and that customers cannot monitor or control,<sup>10</sup> may discourage voluntary clearing.

***B. In a default scenario, use of seized assets in resolution must be subject to strict limitations***

The Consultation describes VMGH as a loss absorption and liquidity resource, which fails to recognize that VMGH involves permitting seizure of the non-defaulting customers' assets.<sup>11</sup> Accordingly, these assets should be described as financing resources in a default loss scenario.

To the extent the FSB includes VMGH in the resolution toolkit to address default losses, use must be narrowly restricted, with access only permitted after other tools have been exhausted. The FSB's guidance should be amended to reflect the severity of this tool. Further, resolution authorities should be required to treat these assets as financing resources, explicitly requiring payable compensation to non-defaulting customers. The costs of compensation should be factored into the analysis of the ultimate costs that will need to be "recovered" when replenishing financial resources necessary to return the CCP to a viable financial position. In addition, resolution authorities should also require the implementation of measures that mitigate<sup>12</sup> the moral hazard associated with the use of VMGH and the potential to discourage clearing. VMGH should be subject to pre-determined caps on the duration and amount of margin that could be subject to haircutting. Resolution authorities should act in a non-discriminatory and transparent manner.

***C. VMGH should never be used to address NDLS***

In an NDL scenario, neither clearing members nor their customers are responsible for the decisions that caused the outcome. Regulated funds and other customers of clearing members

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<sup>9</sup> Consultation at 16.

<sup>10</sup> In the uncleared context, for example, a regulated fund can use a third-party custodian (e.g. EU depository) to remove the ability of a bilateral counterparty to seize its initial or variation margin in the absence of a default by the fund.

<sup>11</sup> Consultation at 16.

<sup>12</sup> To be clear, the suggested measures may mitigate, but do not eliminate entirely, the concerns with VMGH.

play no meaningful role in the day-to-day risk management process of the CCP and, therefore, are unable to control and mitigate the clearing entity's exposure to non-default risks. Typically, NDL risks are solely within the control of the CCP. The FSB should ensure that resolution tools reflect the principle that the CCP and its shareholders are responsible for non-default losses, where such losses result directly from business decisions of the CCP's management.

Accordingly, under no circumstances should VMGH be used to address NDLs. As noted above, VMGH is inconsistent with the resolution parameters. These inconsistencies are magnified exponentially if VMGH is available to address NDLs, where a CCP and its shareholders are typically solely responsible for the loss.

### **III. Transparency is essential to the effectiveness of the toolkit approach**

Transparency of resolution plans is an essential component to their success. We strongly support the Consultation's inclusion of transparency as an element of the proposed international standard for resolution resources. It is critical for clearing members and end-user customers, such as regulated funds, to have the information they need to clearly understand the content of resolution plans. This includes ex ante transparency regarding the likely steps that a resolution authority would take to resolve a CCP in a certain type of scenario, the resources and tools from the toolbox that the resolution authority expects to use at each step of resolution, and the calibration of such resources and tools.

Transparency of resolution plans has clear benefits, enabling CCPs and market participants to better manage their exposures and ensure appropriate levels of risk in the clearing system. The limited number of CCPs offering access to certain markets and authorities' clearing mandates for certain products heighten market participants' need for transparency. When market participants have a more complete understanding of the risks presented by clearing with a particular CCP, including resolution risk, participants can better determine the extent of their potential liabilities and more predictably manage their exposures to a CCP. Increased transparency may also facilitate participants' ability to provide input that ultimately enhances a CCP's risk management function.<sup>13</sup>

However, we note that there is a tension between two of the FSB's objectives, promoting transparency of resolution plans and providing resolution authorities adequate flexibility to respond to unanticipated circumstances. Each of these aspects is important, but we caution that resolution authorities' flexibility should not be limitless. Rather, regulators should find a balance of transparency and flexibility that: (1) provides all market participants with certainty and

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<sup>13</sup> We have previously recommended that the FSB encourage authorities to set out the implications arising from the specific types of products cleared by CCPs and from its ownership structures on the availability of potential loss absorbing resources. This could include, for instance, the "contribution" that each product type makes to the estimated overall risks and resolution costs of the CCP and the implications of the CCP's ownership structure (*e.g.*, mutualized, for profit, etc.) on the relative value of equity and the default fund compared to average levels across other CCPs. Authorities could include this information when making CCP resolution plans public (either in full or a summary of the material portions of each plan). *See* ICI Global's 2020 Letter at 5.

predictability concerning the steps that would be taken to resolve a CCP and (2) affords resolution authorities flexibility to deviate from a resolution plan if doing so would improve substantially the outcome of the resolution proceeding.

#### **IV. Suggested measures to further enhance the effectiveness of the FSB's proposed resolution resource standard**

Considering the importance of transparency and clarity to market participants, we have identified four additional measures that could enhance the effectiveness of the FSB's standard for resolution resources.

First, while the Consultation discusses the merits of the resolution authority triggering resolution prior to the exhaustion of recovery resources,<sup>14</sup> it does not include clear and precise definition of when a resolution begins. We encourage the FSB to provide such a definition as this is an important part of the transparency market participants seek regarding resolution plans, which factors into analyses of potential exposures to a CCP.

Second, while we support the FSB monitoring the steps resolution authorities take to implement the transparency element of this standard through Crisis Management Group (CMG) monitoring and Resolution Assessment Process (RAP) questionnaires, these mechanisms rely on reporting from resolution authorities. These processes do not provide the FSB with feedback from the very market participants for whom transparency is necessary and intended to benefit. We encourage the FSB to incorporate direct feedback from market participants in its implementation monitoring. One way to do so would be to involve market participants in providing feedback to resolution authorities, which can then be incorporated into the reports these authorities make to the FSB as part of the CMG monitoring and RAP questionnaires.

Third, FSB's analysis could be improved with a few adjustments that would enhance clarity for market participants. We encourage the FSB to add an additional parameter that explicitly considers the impact of resolution tools on non-defaulting customers. We also encourage the FSB and authorities, to undertake further quantitative work to calibrate resolution resources and tools and make these results public, consistent with the standard's expectation of transparency. The resolution tool standard would benefit from enhanced clarity from resolution authorities on the distinct tools that would be used to address default losses and NDLs, respectively, and if a tool could be used for both, how the calibration would differ. The FSB should address this concern, thereby enhancing the effectiveness of the toolbox approach, by identifying separate toolboxes for default loss and NDL scenarios.

Fourth, we appreciate that the Consultation specifies that authorities should provide disclosures regarding their approaches to calibrating resolution-specific resources from the toolbox. Yet, the FSB describes such disclosures as being "in a general form." We encourage the FSB to develop guidance on standardized disclosures from resolution authorities regarding resolution tools,

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<sup>14</sup> See, e.g., Consultation at 2.

covering both resolution-specific tools and recovery tools, since non-exhausted recovery tools are also resolution tools. For CCPs, such guidance could be designed in consultation with the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) as an extension of disclosure templates of the Principles for Financial Market Infrastructures.<sup>15</sup> Developed with public input, including from the indirect users of CCPs, the resulting standardized disclosures for CCPs and resolution authorities, could support market participants' assessments of tools and resources through a more comprehensive understanding of the cleared market. Transparency in this manner can enhance market participants' and CCPs' risk management.

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We appreciate your consideration of ICI Global's comments. If you have questions or would like to discuss our comments further, please contact me or Kirsten Robbins at +1-202-326-5800.

Sincerely,

/s/ Annette Capretta

Annette Capretta  
Chief Counsel  
ICI Global

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<sup>15</sup> CPMI and IOSCO, [Principles for financial market infrastructures](#) (April 2012).