

ECSDA Comments on the FSB Consultative Document “Effective Resolution of Systemically Important Financial Institutions”

ECSDA welcomes the FSB consultative report issued on 19 July 2011 with a view to present recommendations for the resolution of systemically important financial institutions (SIFIs) at the G20 Leaders Summit in November.

ECSDA represents 41 international and domestic central securities depositories (CSDs) across Europe. Our members aim to reduce risk and increase efficiency in custody, pre-settlement and settlement services for the European securities market for the benefit of issuers, investors and market participants.

Our comments to the FSB consultation address two dimensions:

- First, the role of CSDs as financial market infrastructures (FMIs), i.e. as a sub-set of SIFIs requiring distinct rules for resolution, as per the work currently undertaken by CPSS-IOSCO on FMI Principles;
- Second, the role of CSDs as service providers to SIFIs, i.e. as institutions potentially affected by the default of a member financial institution falling under the “SIFI” category.

1. General observations

(I)CSDs are currently regulated through a combination of national rules, European rules (Settlement Finality Directive, ESCB-CESR recommendations) and international best practice standards (such as the CPSS-IOSCO recommendations). They are also overseen by national central banks. As a result of these comprehensive requirements, ECSDA members generally support a unified global approach to Standards whereby the new CPSS-IOSCO Principles on Financial Market Infrastructures (FMIs) would constitute a single document of reference, removing the need for parallel Assessments (such as the assessment against the ESCB-CESR recommendations in Europe). We encourage regulators and relevant bodies (including the FSB, CPSS and IOSCO) to coordinate their approach as much as possible to ensure consistency and avoid unnecessary duplication.

While ECSDA understands that the FSB consultation is primarily aimed at systemically significant banks, it is aware that facets of the proposed recovery and resolution regime could eventually be applied to Financial Market Infrastructures including (I)CSDs. (I)CSDs are structured and regulated in a way which mitigates risk to the greatest extent possible. In addition, while banks may be allowed to fail (in an orderly manner), the tasks undertaken by a CSD must continue (for market efficiency and stability reasons) in the (highly unlikely) event of a failure or insolvency. Therefore some of the tools advanced for the resolution of banking problems, such as re-capitalisation or other instruments for the bail-in of creditors, might not be appropriate and could have significant consequences on the structure and ownership of the (I)CSD. Consequently, because of the differences between commercial banks and (I)CSDs and because of their importance to domestic and international securities markets, ECSDA believes that a separate and bespoke arrangement for (I)CSDs is needed in this area.

We understand that a working group of CPSS-IOSCO is working on an FMI-specific resolution framework, and that this should be published for consultation in early 2012. We will therefore reserve our main comments for this consultation. But there are two points to which we would like to respond now, as set out below.

2. Scope of the proposed FSB recommendations

Question 2: Is the overarching framework provided by Annex 1: Key Attributes of Effective Resolution specific enough, yet flexible enough to cover the differing circumstances of different types of jurisdictions and financial institutions?

ECSDA understands that Annex 1 on “Key attributes of effective resolution regimes for financial institutions” is not meant to be applied to CSDs as such, but will be used primarily for credit institutions and other financial intermediaries. ECSDA welcomes the acknowledgement by the FSB that financial market infrastructures (FMIs) like CSDs and CCPs are a special kind of “SIFI” and that **a distinct resolution framework should be elaborated for them in the context of the CPSS-IOSCO work**. In this respect, ECSDA stands ready to discuss how the various aspects of the “Key attributes” could be adapted to encompass CSDs with the special CPSS-IOSCO working group on FMI resolution.

ECSDA agrees that the spirit of FMI resolution regimes should be consistent with the spirit of the “Key attributes”. However, due to the central role played by CSDs and other infrastructures in financial markets, we note that the “liquidation options” presented under Annex 1 of the FSB report for SIFIs should not be applicable to CSDs as their liquidation would generate considerable adverse effects on the efficiency and stability of the financial system. We expect therefore, that the FMI resolution framework will rather focus on developing a set of “stabilisation options” to ensure the continued operation of infrastructures.

In addition, ECSDA believes that not all resolution tools presented by the FSB may be suitable or relevant for FMIs. For example, a more detailed analysis is required to decide if and how resolution tools like the establishment of a bridge institution or bail-in within resolution could be appropriate for FMIs, and for CSDs specifically. We would also suggest that resolution authorities have the flexibility to use the elements of the resolution regime they deem appropriate for an FMI, and that these tools should be agreed as part of the entity-specific RRP.

Furthermore, we understand that the European Commission has been participating in the CPSS-IOSCO work on resolution regimes. A key outcome for CSDs in Europe is that any framework that is agreed for FMIs should arguably have buy-in from the EU Commission so that CSDs are not faced with two different sets of standards. We are facing a similar possible dichotomy in the roll-out of the new CPSS-IOSCO Principles for FMIs during the course of 2012 and similar provisions on, e.g. risk management, governance etc., that will find their way into European legislation on CSDs expected later this year. We trust that the FSB authorities will ensure that resolution frameworks, wherever established, operate to high degree of consistency and harmonised provisions.

Finally, with respect to European FMIs like CSDs, it will be important that any resolution measures respect the existing legal arrangements related to settlement finality as included e.g. in the EU Settlement Finality Directive (SFD).

Question 6: What classes of debt or liabilities should be outside the scope of statutory bail-in powers?

ECSDA is of the view that – for any SIFI - bail-in within resolution should not be applied to liabilities that are resulting from (short-term) transactions related to cash and securities clearing and settlement including repurchase transactions. Conversion of such transaction-related debt into equity would severely hamper the liquidity and efficiency of financial markets, could negatively impact the functioning of FMIs, and could have systemic consequences.

3. Impact of a SIFI failure on CSDs

Question 17: Are the proposed steps to address the obstacles to effective resolution appropriate? What other alternative actions could be taken?

With reference to Annex 6, sub-point 4 on “global payment operations” (page 64), ECSDA thinks that the scope of the paragraph could be broadened to include securities transfers as well.

Question 30: What should be the scope of the temporary stay? Should it apply to all counterparties or should certain counterparties, e.g. CCPs and FMIs, be exempted?

The FSB consultation document envisages the possibility of a “temporary stay” on early termination rights (Annex 8). This means that authorities could suspend the exercise of early termination rights (close-out netting, termination clause etc.) for up to 2 days in order for example to arrange for the transfer of some financial contracts to a sound institution/“bridge company”. We are unclear what effect such a “temporary stay” could have on CSDs. We assume that for the ICSDs, this means that they should not start liquidating collateral (as they would normally do in case of bankruptcy). We would appreciate more guidance on these issues and would urge the FSB to engage (via CPSS-IOSCO) with bespoke discussions on these issues with FMIs and (I)CSDs in particular.

4. Conclusion

ECSDA trusts that its comments will be taken into consideration by the FSB and stands ready to discuss specific measures for FMI resolution with the CPSS and IOSCO. For any questions on this paper, please contact the ECSDA Secretariat at +32 2 234 63 14 or email soraya.belghazi@ecsda.eu.