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15 October 2013

Euroclear response to the FSB consultative report on Application of the Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions

This response is provided on behalf of the Euroclear group of companies ("Euroclear"). Euroclear comprises the International Central Securities Depository ("ICSD") Euroclear Bank ("EB"), based in Brussels, as well as the national central securities depositories ("CSDs") Euroclear Belgium, Euroclear France, Euroclear Nederland, Euroclear UK & Ireland, Euroclear Finland, and Euroclear Sweden.

Appendix I. Resolution of FMIs and resolution of systemically important FMI's participants

Key points

- 1. We welcome the proposal of a resolution regime for Financial Market Infrastructures (FMIs) and the recognition that it needs to preserve the continuity of critical services to the market. We particularly appreciate the recognition by the FSB of the continuity of the FMI's legal environment (including Delivery-versus-Payment (DvP), link and other arrangements) during the resolution phase as being of primary importance to prevent disruptions in the provision of critical services.**
- 2. We welcome the degree of discretion given to the FMIs' resolution authorities in defining and selecting appropriate tools and powers for the FMI's resolution.**
- 3. We appreciate that the guidelines emphasise that all FMIs, irrespective of their licensing status, should be subject to a special resolution regime. In the European Union, the future Bank Recovery and Resolution Directive, however, includes the FMIs with a banking licence in its scope without taking into account the present guidance. We would welcome swift policy efforts to avoid inconsistencies between the global and regional/national frameworks for such FMIs.**

4. **Some operational requirements related to the documentation of the resolution plan seem excessive for smaller FMIs with a very low risk profile. Some degree of proportionality should be applied.**
5. **We would appreciate further clarity on the scope of Part II on systemically important FMI participants. The report should aim to prevent a significant impact on an FMI of the recovery and resolution of that FMI's important participants and critical service providers.**

Detailed responses

Part I of the Draft Guidance: Resolution of Financial Market Infrastructure

1. **Does the draft guidance adequately cover the principal considerations that are relevant to the resolution of each class of FMI (CCPs, CSDs, SSS, PS and TRs)?**

Potential for misaligned regulatory objectives

We appreciate the high quality of the consultation, and believe that the level of detail is adequate and that the principal considerations are addressed. We would like to outline an issue related to the possible application of different recovery and resolution frameworks to FMIs in certain jurisdictions.

The guidelines emphasise that **all FMIs, irrespective of their licensing status, should be subject to a resolution regime that includes the elements and delivers the objectives set out in the Annex¹**. In the European Union however, the future Bank Recovery and Resolution Directive (cf. 2012/0150 (COD)) includes the FMIs with a banking licence. **We would welcome policy efforts to avoid inconsistencies between the global and regional/national frameworks for such FMIs and to avoid double regulation for FMIs with a banking licence.** This contributes to the need for Resolution authorities to have sufficient discretion when activating a resolution regime to ensure that the specific situation of each FMI can be taken into consideration, and that only the relevant tools can be used to deliver a successful resolution.

Would it be helpful if the guidance distinguished more between different classes of FMI? If so, please explain.

The resolution authorities should retain sufficient discretion with regard to the tools they would use, primarily depending on the type of FMI. The elements they need to take into account when doing so are well described in 4.1. Therefore, **we do not believe that a further distinction between different types of FMIs is warranted, as the report does not mandate the use of any particular tool.**

2. **Should any further distinction be made in the draft guidance, for the purposes of applying the Key Attributes, between types of FMI that assume credit risk through exposures to participants and those that do not? If so, for which provisions is that distinction relevant?**

As said above, further distinction seems of limited value, given the character of the guidance. However, if further granularity is to be included within the guidance, it should not focus solely on whether an FMI takes credit/liquidity risk. To do so would result in CSDs with a banking licence being (inappropriately) treated in the same way as CCPs with a banking licence, despite the fundamental

¹ Cf. §2.1, Appendix I of the consultation.

differences between CCPs and CSDs. A more relevant distinction would therefore need to be made between the types of FMIs².

3. Are the additional statutory objectives for the resolution of FMI (paragraph 1.1) appropriate? What additional objectives (if any) should the draft guidance include, relating either to FMIs generally or specific classes of FMI?

The additional statutory objectives for FMI's resolution are appropriate. The ultimate objective of resolution of any institution should remain maintaining financial stability and ensuring the continuation of critical services. The objectives mentioned in the consultation under (i) to (v) are the key elements and are essential for achieving the ultimate objective of preserving financial stability. Points (i) to (iv) are particularly valid for CSDs.

Although point (iv) is valid, not all CSD links are of equal importance. Disruptions to links with smaller markets, or where the FMI has a relatively limited market share, are unlikely to create major disruption. This reinforces the point that Resolution authorities need to have discretion in the activation of Resolution plans.

7. Does the draft guidance (paragraphs 4.1 and 4.2) adequately address the specific considerations in the choice of the resolution powers set out in KA 3.2 to FMIs? What additional considerations (if any) regarding the choice of resolution powers set out in KA 3.2 that should be addressed in this guidance?

We support the FSB in highlighting the importance of the type of critical functions, the capital structure and the available assets for the optimal choice of resolution powers. We appreciate that paragraph 4.4 only applies "where the FMI has rules and procedures for loss mutualisation". Indeed, in contrast to CCPs, CSDs generally do not need (and hence do not have) default resources and loss allocation arrangements (*cf.* 4.1). We agree with paragraph 4.1 (i) stating that the risk profile of the FMI/CSD should be taken into account in the choice of resolution powers.

Implementing recovery or pre-recovery measures in resolution

We agree that recovery measures should also be taken into consideration in resolution. If an FMI has entered directly into resolution or was unable to implement appropriate recovery tools, these could be used in addition to the resolution powers and tools. This may also be valid for other business continuity or risk management measures, the use of which should be taken into account as well.

Additional criteria for appropriate mix of tools

We believe that the criteria identified in our response to the CPSS & IOSCO consultation on Recovery of FMIs, for selecting an appropriate set of recovery tools, would also be applicable for the selection of resolution tools:

- i. The type of losses: e.g. a liquidity shortfall will require a different response from a credit loss; and insurance is particularly useful to cover operational losses.
- ii. The type of FMI: tools should be crafted in line with the FMI's profile and the role it plays, and consequently require different approaches to CCPs, CSDs and other FMIs.

² We believe that CSDs, including those with a banking licence and assuming credit risk, should not be treated in the same manner as CCPs. The purpose of CCPs is very different from that of CSDs (with or without a banking licence), as they have been set up to mutualise risks. Their exposures can be very long-term, not related to business decisions of the CCP itself and are the result of complex transactions that are often difficult to value. It is difficult for a CCP to decide on the exposure it takes on its participant. They also have additional means that can be used in a crisis not available to other FMIs, such as margins. Furthermore, they are also in a relationship with their indirect clients, which is not the case for CSDs. Where a CSD provides credit, the related exposures are very short-term (often intra-day), fully collateralised, transactional and the CSD itself decides upon the credit it is willing to extend.

- iii. The competitive environment: are there alternative providers? Can the resolution authorities simply give time for the participants to withdraw the assets from the FMI in resolution and start using an alternative provider?
- iv. The incentives that loss allocation tools might create: asking participants or service providers to commit to a loss allocation scheme (be it in recovery, or in resolution) could lead to more tiered participation, or even the loss of business from the FMI where that FMI compete effectively with other providers of settlement services, which could shift risk to a less transparent or resilient place.
- v. Dependencies: should any measure be taken with regard to any other institution in order to facilitate the resolution of the FMI?³

8. Are the conditions for entry into resolution of FMI (paragraph 4.3) suitable for all classes of FMI? What additional conditions (if any) would be relevant for specific classes of FMI?

The conditions for entry into resolution are certainly valid for the (I)CSDs (we cannot reply in the name of any other FMIs). We also understand that the authorities may need to react quickly and therefore need certain discretion as provided in point ii. In certain cases, the resolution authorities should however continue close collaboration with the FMI's staff even after the FMI's entry into resolution. In particular this is valid for situations when the losses threatening the FMI's viability result primarily from an IT or another technical problem.

9. Does the draft guidance (and paragraphs 4.4, 4.8 and 4.9 in particular) deal appropriately with the interaction between the contractual loss-allocation arrangements under the rules of certain classes of FMI and the exercise of statutory resolution powers?

On the basis of considerations expressed in our response to question 7, the resolution authorities will determine the appropriate mix of tools. We favour the end-to-end approach to an institution's risk management and believe that the pre-resolution risk management measures (including normal risk management practices among others covered in the CPSS/IOSCO Principles for FMIs, business continuity and recovery measures) should be taken into account when determining whether the tool is appropriate or not.

We consider the mandatory loss sharing by participants or owners to be an inappropriate recovery measure for (I)CSDs. We therefore, agree that the application of some tools (including loss allocation to FMI's participants or owners) in resolution should only be foreseen if they already exist in contractual obligations.

We also agree with the focus made by the FSB on the requirement of continuity upon entry into resolution and the focus of a temporary administrator on the continued provision of critical operations (paragraphs 4.5-4.7). The continuity of a CSD's legal environment is a *sine qua non* condition for ensuring continuity of its critical functions.

10. Should contractual porting arrangements be recognised in the draft guidance on the transfer of critical functions (paragraphs 4.11 and 4.12)?⁴

We agree with the provisions of paragraphs 4.11 to 4.13. Indeed, the transfer of critical activities should result in no disruption to the legislative environment, which would require a legal successor to be recognised in the corresponding sale/transfer legal documentation. This should be enforceable in the relevant jurisdictions. However, some FMIs' services depend on the specific agreements with

³ E.g. in cases of an existing dependency of a CSD without a banking licence on a settlement bank providing cash accounts for DvP settlement in Commercial Bank Money, the authorities should view the CSD's and the designated settlement agent's plans as a package of coherent measures.

⁴ The paragraphs refer to the transfer of functions. Hence, we do not discuss here the transfer of clients' assets.

foreign authorities that cannot be assigned and which are not governed by the laws of the FMI. If these services are critical, the continuity of these agreements and the recognition of an eventual successor may therefore require to be reinforced by additional (non-entity specific) agreements of competent authorities or appropriate modification of such agreements.

11. Are there any other FMI-specific considerations regarding the application of any of the resolution powers set out KA 3.2 that should be covered in this guidance?

Paragraph 4.15 specifically refers to the payments due by the FMIs to participants or to any linked FMI. A resolution authority should be able to exclude from a moratorium *all* payments which are related to or necessary for settlement or other critical CSD services.

13. Are loss-allocation arrangements under FMI rules reflected appropriately in the application of the "no creditor worse off" safeguard in FMI resolution (paragraph 6.1)?

Threats to financial stability, which may result from the application of resolution tools, are not considered in the "no creditor worse off" safeguard and may require an additional provision. While restoring the viability of any financial institution (FMI, bank or other) by using any recapitalisation tool (bail-in or other loss allocation tools), there may be a domino effect where another FMI is impacted as a creditor or a participant.

14. What additional factors or considerations (if any) are relevant to the resolvability of FMIs, or particular classes of FMI (paragraphs 10.3 and 10.4)?

Any recommendation by authorities to implement measures to improve an FMI's resolvability should be well-balanced and take into account the overall impact such measures may have on the smooth and efficient provision of services to the market.

15. Are there additional matters that should be covered by resolution plans for FMIs or particular classes of FMI (paragraphs 11.6 and 11.7)? If yes, please elaborate.

Some requirements related to the documentation of the resolution plan seem excessive for smaller FMIs with a very low risk profile. Some degree of proportionality should be applied.

For the sake of consistency, the Resolution Colleges should preferably be aligned with any Colleges determined in FMI-specific national/regional laws. In the European Union, the CSD Regulation, EMIR and other similar legislation foresee the establishment of supervisory Colleges. Resolution Colleges should be composed of the relevant authorities from the States involved in the supervision of the FMI.

Additional cooperation agreements may be established between the FMI's Resolution authorities and those of their critical service providers and Systemically Important participants, when deemed appropriate. However, these should not necessarily be established with respect to each specific FMI.

16. Are the proposed classes of information that FMIs should be capable of producing (paragraph 12.1) feasible? Are any of the proposed classes of information unnecessary, duplicative or redundant? What additional classes of information (if any) should FMIs be capable of producing for the purposes of planning, preparing for or carrying out resolution?

The information that the authorities should request the FMIs to maintain should depend on its activities. The authorities should have discretion with regard to the exact classes of information from the provided list: all FMIs should not have to provide all the information in the list.

Part II of the Draft Guidance: Resolution of Systemically Important FMI participants

General remark

We understand that the criteria for definition of a systemically important participant focuses on a participant that is a recognised SIFI in its own jurisdiction or globally. **The report should also consider how best to prevent any significant impact on an FMI which could be caused by the recovery and resolution of that FMI's main participants or critical service providers.**

18. Does the draft guidance achieve an appropriate balance between the orderly resolution of FMI participants and the FMI's ability to manage its risks effectively?

The rules should primarily seek to protect the FMI. Protection of FMIs from the consequences of resolution of participants is of major importance in order to prevent threats to financial stability. If FMIs are expected to contribute to facilitating the orderly resolution of participants, they should get sufficient comfort from the authorities that this would not force them to run risks beyond their risk appetite.

20. Are the safeguards set out in the guidance (paragraph 1.3) adequate as regards the conditions and requirements for maintaining access of a firm in resolution or admitting as a new member an entity to which that firm's activities have been transferred? If not, what additional safeguards should be included in the guidance?

The participant should at all times continue to meet the criteria for FMI participation. Such criteria are principally risk-based and ensure that the client's participation does not result in inappropriate risks for the FMI or for other FMI participants.

21. Are there any other issues in relation to the handling of the failure of FMI participants that it would be helpful for the FSB to clarify in this guidance? If yes, please elaborate.

As mentioned, the role of some financial players is not always limited to that of an FMI participant, therefore the resolvability assessment of the FMI participant should also include an assessment of the impact on the FMI in a broader sense than mentioned in point iii. The assessment should also take into account the FMI's reliance on the relevant financial market participant in other roles than that of FMI participant (e.g. cash correspondent, settlement agent, paying agent etc.).

Appendix III. Client Asset Protection in Resolution

General remarks

- 1. We agree with the FSB approach aiming to prevent unavailability of securities to the clients with a consequent impact on investors.**
- 2. However, Client Asset Protection (CAP) in resolution should fit into a broader framework of measures. It is a transversal matter, which has to be made effective in the day-to-day management of any deposit-holding institution. Therefore, CAP provisions also need to be incorporated in an eventual legislation dealing with management of institution's client's custody risk.**
- 3. In the case of a CSD which operates the dematerialisation or immobilisation records, prompt access to the clients' assets is the most relevant objective, whereas a transfer or a return of assets may not be possible (because the CSD's account holder already has the most direct right possible over the security).**
- 4. CSDs already have an extremely strong CAP provisions as part of the requirements applicable as part of their day-to-day risk management covered by the CPSS/IOSCO Principles for FMIs and the future EU CSD Regulation. The difference of approaches of the crisis and non-crisis frameworks (functional – for Client Asset Protection in Resolution, and institutional - for CPSS & IOSCO PFMI and provisions on FMI Recovery and the future FSB guidance on Resolution for FMIs) appears inconsistent.**

Detailed responses to the most relevant questions

34. Are the distinct but complementary roles of the draft FSB guidance and the IOSCO Recommendations Regarding the Protection of Client Assets sufficiently clear?

The FSB Guidance sets out a number of pre-insolvency asset protection principles which are not specific to resolution: they will apply in the normal course of business and support a resolution event, if one occurs. Because of the general nature of the Guidance, there seems to be some overlap with the IOSCO Recommendations Regarding the Protection of Client Assets. We also note that FMIs are subject to similar, but more detailed and FMI/CSD-specific asset protection requirements in the CPSS & IOSCO Principles for Financial Market Infrastructures.

It is not clear to us how all of these documents are intended to interact with each other and which one prevails in case of inconsistency. We would therefore ask for policy efforts to ensure consistency between the pre-crisis and the crisis CAP frameworks for CSDs.

35. Does the draft guidance deal adequately with the different types of firms and the range of their activities in the course of which they hold client assets, including investment business, prime brokerage and custody services? If not, what additional types of firms or activities should be covered?

Although the ultimate objective of protecting clients' assets is the same, the authorities may need some additional flexibility in how they apply the Guidance to CSDs (*please see below*).

36. Are the additional statutory objectives for the resolution a firm with holdings of client assets (paragraph 1.1) appropriate? What additional objectives should be included?

The additional statutory objectives do not fully reflect the role and functioning of a CSD. Clients' access to their assets is already covered by the primary resolution objectives for FMIs set out in Section 1.1 of Appendix 1 of the Consultation document which highlights the needs to continuity of critical FMI functions. The possibility of returning assets or transferring client assets to another entity should indeed be seen against the need to preserve the continuity of a CSD's critical services, including safekeeping and settlement.

Secondly, the specific CAP resolution objectives foresee prompt access, rapid return or transfer of the client holdings as different alternatives to meet the asset protection objective. In the case of a CSD which operates the dematerialisation or immobilisation records, prompt access to the assets is the most relevant objective, whereas a transfer or return of the asset may not be possible (because the CSD's account holder generally already has the most direct right possible over the security).

If the Guidance were to cover CSDs, we suggest giving the resolution authorities the necessary flexibility to apply it in the most appropriate manner.

We would welcome the opportunity to discuss any of these comments in further detail.

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