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Financial Stability Board

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EACH RESPONSE TO THE FINANCIAL STABILITY BOARD CONSULTATIVE DOCUMENT ENTITLED "APPLICATION OF THE KEY ATTRIBUTES OF EFFECTIVE RESOLUTION REGIMES TO NON-BANK FINANCIAL INSTITUTIONS"

EACH, the European Association of Central Counterparty Clearing Houses, welcomes the opportunity to respond to the FSB Consultative Document on Application of Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions ("the Consultation").

EACH understands resolution as a regime which occurs before insolvency and which is implemented by authorities. Effective resolution regimes should have the attributes of legal certainty, clarity and efficiency for authorities and affected market participants alike. Therefore, EACH very much welcomes the regulatory guidance provided by the FSB on effective resolution regimes. EACH notes that resolution regimes will depend on local insolvency law and therefore there is no "one size fits all" solution. However, EACH believes that authorities should endeavour to implement resolution regimes for CCPs consistently across jurisdictions to avoid competitive arbitrage.

EACH would like to focus its input on the following questions:

Responses to specific questions in Part I: Resolution of FMI and Systematically Important FMI participants

a) *Question 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 What additional objectives (if any) should the draft guidance include, relating either to FMIs generally or specific classes of FMI?*

   Paragraph 1.1 states that the aim of resolution should be to achieve continuity of the FMI, including timely settlement of obligations due to participants. We agree that these are key objectives. We do not believe however that they should over-ride all other considerations, including stability of the financial system and protection of assets, which should be added as objectives in relation to FMIs.

b) *Question 5: Should resolution authorities have a power to write down initial margin of direct or (where appropriate) indirect participants of an FMI in resolution (paragraph 4.8)? If so, should the power be restricted to initial margin that is not 'bankruptcy remote' and may be used to cover the obligations of participants other than the participant that posted it? What are the implications of such a power for FMIs and participants? Are any further conditions appropriate in addition to those specified in paragraph 4.9?*

EACH is of the opinion that bankruptcy remoteness of margins is an issue for initial margin haircutting. So is the potential complication of introducing increased capital charges for initial margin, and the fact that in a number of jurisdictions such haircutting of initial margin would not be legal. EACH believes that for all these reasons initial margin haircutting should not be used to cover losses other than those incurred by the participant who posted the initial margin.

c) *Question 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?")*

See comments to question 9 below.

d) *Question 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?")*

The proposals set out in paragraph 4.3 concerning the point at which resolution is triggered are not fully consistent with paragraph 4.4. EACH considers that within each jurisdiction, full clarity must be provided as to where the boundary lies between recovery and resolution and FMIs should be empowered to perform their recovery plans before any resolution is initiated by the authorities. Without full clarity, the effectiveness of a CCP's recovery arrangements will be jeopardised, because clearing members, on whose participation recovery depends, may seek to protect themselves from the unquantifiable risk of ad-hoc intervention from public authorities. This could lead to undesirable outcomes before resolution commences.

e) *Question 10 ("Should contractual porting arrangements be recognised in the draft guidance on the transfer of critical functions (paragraphs 4.11 and 4.12)?")*

EACH believes that the transfer of critical functions to a third party is likely to be impractical, for a number of logistical, legal and operational reasons. Such transfers are likely to be possible only between CCPs with overlapping membership and products. Such CCPs are likely to be similarly affected by the severe conditions which caused the CCP failure. Even if this were not the case, it is unlikely that a CCP would be prepared to accept the transfer of open interest from what is likely to be a broken market. It would be unacceptable for a resolution authority to force a viable CCP to accept such transfer of open interest from a failed CCP against its will. Whilst we agree that a resolution authority should be able to effect such a transfer without the consent of the failed CCP, it should not be able to do so without the consent of the viable CCP to which the contracts are to be transferred.

f) *Question 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 4.8 (iii) proposes write down or conversion to equity of any outstanding debt of the FMI. We believe that the scope of debts available for write down or bail in should be limited in scope to participants/counterparties, to avoid capturing debts such as providers of services and employees.

Paragraph 4.9 states that equity of a FMI should be written down prior to other steps being initiated. It is unclear what the meaning of this statement is. The value of equity will adjust to the value of assets and commercial situation of the company – it is not appropriate for the write-down of equity to be identified as a resolution activity, or for shareholders to be assessed for more than what they have invested.

g) Paragraph 4.15 states that a resolution authority should not impose a moratorium on payments due by the FMI. Whilst not desirable, in certain circumstances the putting in place of such a moratorium, a temporary suspension of the market or "false weekend" may be appropriate measures, and we do not understand the reasons for those to be excluded as a possible resolution tool.

h) *Question 12. ("Does the draft guidance (paragraphs 5.1 and 5.2) deal appropriately with the considerations that are relevant to the decision whether to stay the exercise of early termination and set-off rights by FMI participants on the entry into resolution of the FMI? Should the guidance distinguish between different classes of FMI in this regard?")*

The stay of termination rights within resolution arrangements could be counterproductive. Whilst it is acknowledged in paragraph 5.2 that the resolution authority should take into account the effect of implementing such power on the orderly operations of the FMI, it is possible that the threat alone of such a stay is sufficient to incentivise termination by clearing members prior to the resolution phase.

i) *Questions 14 and 15 ("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)?";"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.")*

Sections 10.3 and 11.7 attempt to provide a high degree of predictability and certainty to a resolution process which by its very nature is likely to be characterized by a high degree of uncertainty and a need for flexibility of response.

In certain cases these provisions also go beyond what is required for systemically important financial institutions other than FMIs, including banks and insurance companies. Specific examples of where these provisions go beyond what is required for other systemically important institutions is the requirement for draft transition agreements and a purchaser's pack. It is not clear what the rationale for this is.

j) *Question 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?")*

CCPs should be able to produce the information suggested in the report except with respect to indirect participants. CCPs always hold information on direct participants but not necessarily on indirect participants (i.e. clients of clearing members).

k) *Question 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")*

We agree that the CCPs' rules should not hamper unnecessarily the orderly resolution of a participant and that a participant should generally be able to continue to participate in the CCP as long as it performs its obligations. However, there may be circumstances where local bankruptcy laws consider any delay in exercising the termination of a firm's participation to effectively be a waiver of such rights. In these circumstances the CCP cannot be expected to exclude the automatic termination of participation in its rules. We recommend that the final guidance recognises such cases.

Responses to specific questions in part III: Client Asset Protection in Resolution

l) *Q37. Is the proposed definition of 'client assets' (paragraph 2.1) sufficiently comprehensive? Are there any other classes of assets (in addition to those specified in paragraph 2.2) that should be excluded from the scope of this guidance?*

We seek confirmation that the term client assets covers assets held outside a CCP. It is important in terms of ensuring the operation of CCPs in accordance with clearing regulation for the provisions set out in this paper in respect of client assets not to apply to assets held at a CCP. Against this background, a clearer definition of client assets in the final guidance would be desirable.

m) *Question 39 ("Is the interaction between transfer powers and contractual porting arrangements or other arrangements under the rules of CCPs, exchanges or trading platforms (paragraph 3.3) sufficiently clear? If not, please explain what aspects might usefully be clarified.")*

We believe that para 3.3 is unclear and would need to be clarified. We would however like to stress that it is crucial to provide for certainty that CCPs' default rules as well as operation of porting arrangements can be exercised and cannot be hampered or interfered by transfer powers of resolution authorities.

n) *Q48. Are the classes of information that firms should be able to provide promptly in order to facilitate the rapid transfer or return of client assets (paragraph 8.1) feasible? What additional classes of information (if any) should firms be capable of producing for those purposes?*

The CCP does not have all the information listed under paragraph 8.1 available. Ensuring full traceability of client assets and collateral throughout the holding chain, in particular for indirect holding model would be very difficult in practice.

EACH would welcome the opportunity to discuss the contents of its response with you, particularly if you require any clarification about the contents of this response.

Should you require further information, please do not hesitate to contact the undersigned.

Yours sincerely,

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About EACH

European central counterparty clearing houses (henceforth CCPs) formed EACH in 1992. EACH's participants are senior executives specialising in clearing and risk management from European CCPs, both EU and non-EU. Increasingly, clearing activities are not restricted exclusively to exchange-traded business. EACH has an interest in ensuring that the evolving discussions on clearing and settlement in Europe and globally, are fully informed by the expertise and opinions of those responsible for providing central counterparty clearing services.

EACH has 22 members:

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This document does not bind in any manner either the association or its members.

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