

MEMO# 31358

August 29, 2018

Draft ICI Comment Letter on Incentives to Centrally Clear OTC Derivatives - Member Comment Requested by Wednesday, September 5

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August 29, 2018 TO: Derivatives Markets Advisory Committee
ICI Global Trading & Markets Committee RE: Draft ICI Comment Letter on Incentives to Centrally Clear OTC Derivatives - Member Comment Requested by Wednesday, September 5

The Basel Committee on Banking Supervision, the Committee on Payments and Market Infrastructures, the Financial Stability Board and the International Organization of Securities Commissions (collectively the “standard setting bodies” or “SSBs”) recently issued a consultation on the incentives to centrally clear over-the-counter (OTC) derivatives.^[1] The Consultation is part of a broader effort by the SSBs to evaluate the progress of reforms to OTC derivatives markets following the financial crisis of 2008.

ICI Global has prepared the attached draft comment letter in response to the Consultation. If you have comments on the draft, please send them to George Gilbert at george.gilbert@ici.org by Wednesday, September 5.

The draft letter explains that regulated funds generally support the objective of increasing the clearing of standardized derivatives products, but expresses concern that the resolution plans for central counterparties (CCPs) do not adequately protect customer assets. This creates a disincentive for clearing. The draft letter recommends that the SSBs revise their guidance on CCP resolution in four ways to improve customer protections and promote increased clearing of OTC derivatives:

- First, the SSBs should revise their guidance to delineate expressly between recovery and resolution. The revised guidance should specify that a resolution proceeding commences any time that a CCP has depleted its own resources and the resources of clearing members that are committed to the CCP’s recovery. At this stage, the CCP cannot continue to provide clearing services without external funding, and resolution authorities should step in to determine whether and how to provide this bail-out.
- Second, the SSBs should recommend that resolution authorities adopt resolution strategies that allocate losses and provide for replenishment of financial resources by

those market participants that caused or contributed to a CCP's failure, that can control the amount of risk they bring to or allow in the CCP (as clearing members or owners), and that have the ability to monitor or manage the CCP's risk-taking and management activities.

- Third, the SSBs should revise their guidance to clarify that resolution authorities may access non-defaulting customer assets only in resolution and only as a last resort, after other tools have been exhausted. The SSBs also should recommend limiting any use of non-defaulting customer assets to scenarios involving default losses (i.e., losses caused by the default of a clearing member). A CCP and its shareholders should bear all responsibility for non-default losses because these losses result directly from business decisions of the CCP's management and the CCP's management is the only group able to control and mitigate the CCP's exposure to these losses.
- Fourth, guidance should, as much as possible, encourage national regulators and resolution authorities to be transparent about the tools and strategies they will use to resolve a failed CCP. Market participants that understand a clear plan exists to resolve a failing CCP likely will not panic upon activation of the plan, at least if they have confidence the plan will be followed. Instead, their response should be measured and proportionate to the risk that the plan presents to their business. If, however, market participants question whether authorities have a plan to resolve a financially distressed CCP, lack adequate information concerning the risks that a resolution plan presents to their business, or believe authorities will abandon the plan, they would have every incentive to exit the market at the first sign of CCP distress, possibly exacerbating stress at the CCP.

George M. Gilbert
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[Attachment](#)

endnotes

[1] Incentives to centrally clear over-the-counter (OTC) derivatives: A post-implementation evaluation of the effects of the G20 financial regulatory reforms (August 7 2018), *available at* <http://www.fsb.org/wp-content/uploads/P070818.pdf> (Consultation). For a summary of the Consultation, see ICI Memorandum No. 31335 (August 16, 2018), *available at* https://www.ici.org/my_ici/memorandum/memo31335.