

MEMO# 28482

October 23, 2014

CPMI and IOSCO Issue Report on the Recovery of Financial Market Infrastructures

[28482]

October 23, 2014

TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 28-14
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 72-14
ICI GLOBAL MEMBERS No. 46-14
INTERNATIONAL MEMBERS No. 36-14 RE: CPMI AND IOSCO ISSUE REPORT ON THE
RECOVERY OF FINANCIAL MARKET INFRASTRUCTURES

On October 15, 2014, the Committee on Payment and Market Infrastructures (“CPMI”) and the International Organization of Securities Commissions (“IOSCO”) published a report entitled Recovery of Financial Market Infrastructures. [\[1\]](#) The purpose of the FMI Recovery Report is to provide guidance to financial market infrastructures (“FMIs”), such as central counterparties (“CCPs”), on how to develop plans to ensure recovery from threats to their viability and financial strength while also ensuring that these FMIs continue to provide critical services. The guidance discusses relevant authorities in carrying out the responsibilities associated with both the development and implementation of these recovery plans. The FMI Recovery Report supplements the CPSS and IOSCO “Principles for Financial Market Infrastructures” published in April 2012, [\[2\]](#) and is consistent with the “Key Attributes of Effective Resolution Regimes for Financial Institutions” of the Financial Stability Board. [\[3\]](#)

The FMI Recovery Report provides guidance on the recovery planning process and the content of recovery plans, including some of the tools that an FMI may include in its recovery plan. The report considers recovery tools that fall into five categories: tools to allocate uncovered losses caused by participant default; tools to address uncovered liquidity shortfalls; tools to replenish financial resources; tools for a CCP to re-establish a matched book; and tools to allocate losses not related to participant default. To allocate uncovered losses caused by participant default, the FMI Recovery Report discusses the following tools: cash calls, variation margin haircutting, use of initial margin, and other tools involving collateral and capital.

During the consultation process, ICI and ICI Global opposed the use of variation margin and initial margin haircutting as recovery tools because the margin of non-defaulting indirect

participants could be used to support the recovery of a CCP. We expressed concern that these tools would impose unfair costs of recovery of CCPs on entities that did not contribute to the losses or default or have the ability to manage the CCP's risk taking and management activities. [4]

Although the FMI Recover Report continues to include variation margin and initial margin haircutting as recovery tools, it does note some disadvantages to these tools. In particular, the FMI Recovery Report states that variation margin haircutting does not necessarily allocate losses to those who are best able to cope with them. The report notes that variation margin haircutting may be considered by some authorities to be an inappropriate tool for CCPs that primarily serve retail investors because such investors may lack the ability to measure and manage the risk of the potential failure of a CCP. With respect to initial margin, the FMI Recovery Report states that indirect participants of CCPs in particular may be unable or unwilling to participate in a CCP if their initial margin is subject to loss for reasons other than their own default.

Jennifer S. Choi
Senior Associate Counsel Securities Regulation

endnotes

[1] See Recovery of Financial Market Infrastructures, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD455.pdf> ("FMI Recovery Report").

[2] See Principles for Financial Market Infrastructures, available at <http://www.bis.org/cpmi/publ/d101a.pdf>.

[3] See Key Attributes of Effective Resolution Regimes for Financial Institutions, available at http://www.financialstabilityboard.org/publications/r_141015.pdf.

[4] For a summary of the comment letter, see ICI Memorandum No. 27632 (Oct. 10, 213), available at <http://www.ici.org/iciglobal/pubs/memos/memo27632>.