

**MEMO# 31372**

September 7, 2018

# ICI Global Files Comment Letter on Incentives to Centrally Clear OTC Derivatives

[31372]

September 7, 2018 TO: Derivatives Markets Advisory Committee  
ICI Global Trading & Markets Committee RE: ICI Global Files Comment Letter on Incentives to Centrally Clear OTC Derivatives

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 whether adequate incentives exist 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 recently filed the attached comment letter in response to the Consultation. The letter explains that regulated funds generally support the objective of clearing standardized derivatives products, but expresses concern that the resolution plans for central counterparties (CCPs) do not adequately protect assets of non-defaulting customers. This creates a disincentive for clearing. The 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 specify that a resolution proceeding commences no later than when a CCP has depleted its own resources and the resources of clearing members that are committed to the CCP’s recovery (*i.e.*, resources established under prudential requirements designed to ensure that a CCP can meet its obligations, including the CCP’s own capital and clearing member guarantee fund deposits). 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 best resolve the CCP.
- 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 or that can control the amount of risk they bring to or allow in the CCP (as clearing members or owners).

- 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 methodology and process for seizing assets of non-defaulting customers should be fair, transparent, and subject to pre-determined caps, and these customers should be fully compensated for their loss. 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.

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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](https://www.ici.org/my_ici/memorandum/memo31335).