

MEMO# 33456

April 14, 2021

UK Consultation on an Expanded Resolution Regime for UK CCPs - Member Comments Requested by 23 April 2021

[33456]

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TO: Derivatives Markets Advisory Committee

ICI Global Brexit Task Force RE: UK Consultation on an Expanded Resolution Regime for UK CCPs - Member Comments Requested by 23 April 2021

On 24 February 2021, Her Majesty's Treasury (HMT) published[\[1\]](#) a consultation[\[2\]](#) on expanding the resolution regime for UK Central Counterparties (?UK CCPs?). The proposed regime will provide the Bank of England (BoE) ? the supervisor and resolution authority (RA) for UK CCPs ? with additional powers to mitigate the risk and impact of a UK CCP failure and the subsequent risk to financial stability and public funds. HMT is seeking comments on its proposals by 28 May 2021. The consultation and ICI Global's proposed response are summarised below. We are seeking member comments on our draft response by close of business on Friday 23 April 2021.

Consultation

In the consultation, HMT summarises the UK's existing regime and recent international policy developments, including the guidance developed by the Financial Stability Board[\[3\]](#) and the EU's regulatory framework.[\[4\]](#) HMT is seeking to further develop the UK regime to bring it in line with international standards, support financial stability and ensure the UK remains a world leader for the regulation of clearing services.[\[5\]](#)

In our response to the consultation we plan to support many aspects of HMT's proposals. To ensure the fair treatment of CCP customers and to strike an appropriate balance between providing certainty to market participants regarding the CCP resolution process, while allowing the BoE sufficient flexibility to respond to unanticipated circumstances, we recommend the following changes:

- Define resolution as the point at which the CCP has depleted its own recovery

resources and the resources of clearing members that are committed to the CCP's recovery.

- Place greater reliance on resolution tools that use the resources of entities responsible for the CCP's risk management (e.g., the CCP itself and its members and shareholders), rather than using tools that seize resource from non-defaulting customers (NDCs).
- Set out in as much detail as possible how the BoE's proposed general powers, such as tools to return the CCP to a match book, will be used and how these will work in practice.
- Take account of the impact of the BoE's proposed loss-allocation powers and safeguards on CCP customers, such as regulated funds, including deviation from the CCP's rules and arrangements and the use of variation margin gains haircutting (VMGH).
- Limit the use of the BoE's other powers, such as VMGH and contract tear ups (CTUs) to replenishment scenarios where public funds have been used as a last resort in the public interest, when other tools have been exhausted, and subject to additional safeguards, including the involvement of CCP customers.

Current regime

HMT describes the current UK regime for CCP resolution,^[6] noting that the following conditions must be met before resolution is triggered:^[7]

- The BoE, as the RA, must be satisfied that a CCP is failing or likely to fail and that it is not reasonably likely that action will be taken by or in respect of the CCP that will enable the CCP to maintain the continuity of critical clearing services; and
- The decision to put the CCP into resolution is in the public interest (i.e., the financial stability of the UK and the maintenance of public confidence in the stability of the financial system).

In our response to the consultation, we plan to recommend that HMT more precisely defines the trigger for resolution as the point at which a CCP has depleted its own resources and the resources of clearing members that are committed to the CCP's recovery. We argue that, at this stage, the CCP cannot continue to provide clearing services without external funding and the BoE should determine whether to provide additional funding to the CCP under the auspices of a resolution plan.

Proposed Regime

HMT proposes that the BoE would have additional powers to mitigate the risk and impact of a CCP failure and the subsequent risks to financial stability and public funds. HMT argues that the new powers would better protect financial stability by enabling the BoE take faster and more extensive action to stabilise a CCP than it can now. Once finalised, HMT will consider how best to legislate for the new regime when UK parliamentary time allows.

As set out in more detail below, HMT has proposed the following three categories of powers for BoE: general powers, loss-allocation powers and safeguards; and other powers. HMT states that when used together, the proposed powers and tools form a robust regime which would give the BoE the flexibility to effectively: (i) stabilise a CCP, so that it can continue to provide its critical clearing services; (ii) prevent contagion spreading across the financial system; and (iii) ensure losses are allocated fairly across CCPs and clearing members, rather than to taxpayers.

General Powers

HMT proposes a range of general powers for the BoE to use during the resolution of a CCP. In our response to the consultation, we plan support many aspects of the proposed powers, including removing material impediments to resolvability, restricting or prohibiting remuneration of equity in severe circumstances, suspending termination rights, taking control of the CCP, and making senior management changes.[\[8\]](#)

HMT has proposed that the BoE should be able to place a CCP in resolution before the CCP's own recovery measures have been exhausted if continuing recovery actions by the CCP would likely compromise financial stability. Furthermore, HMT has proposed converting the current requirement for the BoE to consult with HMT before taking such action into an ex-post obligation.[\[9\]](#) In our response to the consultation, while we acknowledge that there may be circumstances where financial stability risks may dictate the BoE taking prompt action, we plan to argue that appropriate account should be taken of the implications for wider market confidence of such action. Sudden action by the BoE that does not match the expectations of investors or market participants may result in sudden market withdrawal, which in turn may exacerbate market stress.

HMT has proposed that the BoE should be able to direct senior management changes at a CCP (e.g., removing or replacing directors or senior executives, including with temporary managers).[\[10\]](#) We plan to support this proposed power, but recommend that HMT and/or the BoE provide greater clarity about the role of the CCP's senior management during and after resolution to avoid creating moral hazard and perverse motivations, if the same management team that led a CCP into ruin can continue to control the enterprise following resolution.

HMT has proposed that customer funds, including through contract tear-ups (CTUs), can be used to return a CCP to a matched book.[\[11\]](#) We plan to push back on these proposals, on the basis that they pose a serious risk to NDCs of clearing members. Furthermore, that they are a mechanism to transfer assets of NDCs to the CCP and its shareholders, and penalise CCP users that play no meaningful role in CCP risk management and have not contributed to the CCP's distress. On the basis that such tools are adopted, to provide certainty, build trust, and promote fair treatment for all stakeholders, we recommend that the BoE sets out in detail how it will take ensure that CTUs are undertaken in a fair, transparent and non-discriminatory manner.

Loss-allocation powers and safeguards

We plan to support the proposed a no creditor worse off (NCWO) in liquidation safeguard ? providing a right of compensation for creditors of the CCP that are left worse off in resolution than the would have been on the absence of resolution action. We also plan to support excluding initial margin from the BoE's proposed write down power.[\[12\]](#)

HMT has proposed that the BoE would have the power to perform VMGH. We plan to strongly object to the use of VMGH to provide additional loss absorbing capacity in resolution, even where this is limited to default loss scenarios (as has been proposed by HMT). We argue that such an approach unfairly penalises NDCs. Furthermore, that the use of such tools may ultimately discourage voluntary clearing, create moral hazard by incentivising CCPs and their clearing members to take excessive risks, or destabilise markets by incentivising clearing members and CCP customers to liquidate trades in anticipation of adverse outcomes in times of stress.

Other powers

HMT has proposed that the BoE will have the power to use statutory loss allocation tools such as VGMH and CTUs to recapitalise the CCP and replenish its prefunded resources, rather than just absorb losses.^[13] While we acknowledge that the use of tools such as VGMH and CTUs would be subject to the NCWO safeguard, the extent to which clearing members pass on compensation to CCP customers is down to their commercial agreement.^[14] As such, if HMT decides to enable the BoE to use VGMH and CTUs, we recommend that in order to ensure fair treatment of CCP customers, their use should be subject to:

- robust and inclusive governance processes, including the involvement of CMs and customers;
- pre-determined caps;
- use in a non-discriminatory and transparent manner; and
- applied on a gross rather than net basis.

Next Steps

Please provide comments on ICI Global's proposed response by close of business on Friday 23 April 2021. We plan to file our response by the 28 May 2021 comment deadline. HMT will consider the responses and how best to legislate for the new regime when UK parliamentary time allows.

Giles Swan
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ICI Global

[Attachment \(in .pdf format\)](#)

endnotes

[1]

<https://www.gov.uk/government/consultations/expanded-resolution-regime-for-central-counterparties-ccp-consultation>

[2] Expanded Resolution Regime: Central Counterparties, February 2021, available from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/962168/Expanded_Resolution_Regime_for_Central_Counterparties_-_Consultation__002_.pdf

[3] The Financial Stability Board has developed various guidance on CCP resolution, including Guidance on Central Counterparty Resolution and Resolution Planning, Financial Stability Board, 5 July 2017, available from <https://www.fsb.org/wp-content/uploads/P050717-1.pdf> and more recently Guidance on

Financial Resources to Support CCP Resolution and on the Treatment of CCP Equity in Resolution, Financial Stability Board, 16 November 2020, available from <https://www.fsb.org/wp-content/uploads/P161120-1.pdf>

[4] Regulation 2021/23 on a framework for the recovery and resolution of central counterparties, available from <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32021R0023>

[5] Consultation at 1.1-1.7

[6] Chapter 5, UK Banking Act 2009, available from <https://www.legislation.gov.uk/ukpga/2009/1/part/1/crossheading/uk-clearing-houses>

[7] CP at 1.23

[8] CP at 2.1-2.8

[9] CP at A.11

[10] CP at 2.7

[11] CP at 2.8

[12] CP at 2.13

[13] CP at 2.15

[14] CP at 2.16