Response to the consultation
"Expanded Resolution Regime: Central Counterparties"

Executive Summary

Clearing Members and clients[1] of the Futures Industry Association and the International Swaps and Derivatives Association (together the Associations) welcome HM Treasury's (HMT) proposals for an expanded resolution regime for UK CCPs, which, due to the UK's active participation and contributions, are mostly in line with international guidelines and are closely aligned with the EU's CCP Recovery & Resolution framework.

Resilient and robust clearing is extremely important to the Associations' membership, consequently, the Associations have been significantly involved in the discussion on CCP recovery and resolution, including developing tools like Variation Margin Gains Haircutting (VMGH) and Partial Tear-Up (PTU).

We appreciate the high-level detail provided in this consultation, which is appropriate when consulting for an overall legal framework. However, we encourage HMT to conduct subsequent consultations of the proposed legal text to enable the review of more detailed requirements, and to facilitate further discussions and feedback.

We are broadly in agreement with the proposed framework, but have the following key comments and recommendations:

- Due to the global nature of UK CCPs, we recommend including language in the UK's final framework that the Resolution Authority (RA) will have due regard to financial stability implications for third countries when resolving a failed CCP.
- The current proposal would disproportionately allocate losses to clearing members despite the inclusion of a No Creditor Worse Off (NCWO) framework.
- We recommend the inclusion of compensation for clearing participants (clearing members and their clients) for all losses in recovery and resolution.
- The power to suspend early termination rights needs to be more clearly defined to ensure it does not impact legal netting.
- We question the appropriateness of the CCP in resolution determining a "commercially reasonable tear up price", especially in light of the fact that PTU is not considered a tool for loss allocation.
- We welcome that the NCWO safeguard includes fewer indirect costs that are difficult to value (like for instance re-hedging cost under stressed market conditions or cost for margin at a new CCP) but would appreciate more details to fully assess the proposal.

[1] This consultation response covers the positions of our members that are clearing members and their clients. The paper does not reflect the views of many CCPs, and many of the CCPs are in disagreement with the views expressed herein.

- We welcome the introduction of a second tranche of CCP skin in the game (SITG), yet we propose that the second tranche should be at a minimum the size of the first tranche, given that UK CCPs are globally systemically important.
- We strongly recommend not to use cash calls to cover non-default losses (NDL), as these risks are solely managed by the CCP. CCP equity should be right-sized to deal with potential NDL.
- We do not agree that loss allocation tools such as cash calls or VMGH should be used for recapitalising a failed CCP. This is particularly so when such tools may be utilized without passing the ownership of the CCP to the clearing participants who provided the new capital.
- We welcome that initial margin (IM) is excluded from the write-down tool. This however means that the only significant resource that can be written down will be the default fund; not only is it inappropriate to use this to cover NDL, it also places the majority of loss absorption on clearing members.
- While we recognise certain advantages of the power to delay enforcement of a clearing member's obligation, we strongly recommend HMT implements this power in an equitable manner and carefully analyses the interplay with the NCWO safeguard.

General Comments

While recognizing the consultation's scope is limited to enhancing the UK's resolution regime for UK CCPs, we would also welcome further standards and requirements for CCP recovery plans and restrictions of certain recovery tools. CCP recovery and resolution are inextricably linked, given that the resources provided to cover losses stem largely from the same sources across all phases. We understand that recovery should be covered by regulation provided by the Bank of England (BoE). In any event, we recommend further standardisation in these areas.

We welcome that the consultation proposals do not include forced allocation or IM haircutting as tools for recovery or resolution. We also welcome a NCWO safeguard that restricts cost in the counterfactual to direct costs, as well as the introduction of a second tranche of SITG and the power to restrict dividends, variable remuneration and buy-backs.

Transparency

We recommend HMT add minimum levels of transparency for CCP resolution plans.

Clearing participants (clearing members and their clients, together CPs) need to have a sufficient level of understanding of potential resolution actions. Without such an understanding, CPs' actions will be based on a worst-case scenario and in some cases could be procyclical. Enhancing transparency and predictability for CPs will enable them to plan more appropriately for recovery and resolution scenarios and ensure that CPs' actions are in line with the RA's goals, which overall enable a better outcome for financial markets.

Principles (1.7)

The consultation sets out a number of underlying principles for the CCP resolution regime. Principles B and C – regarding "*protecting and enhancing the stability of the financial system of the UK*" and "*protecting and enhancing public confidence in the stability of the financial system of the UK*" – are domestically focused. Given the high-degree of cross-border interconnectivity of UK CCPs with the global financial system, we propose adding further focus on the international aspects of financial stability. The UK CCPs service the global markets. By way of example, two UK CCPs have been classified as systemically important by the EU, and two CCPs are fully registered as a Derivatives Clearing Organization with the US Commodity Futures Trading Commission. As such, the principles should acknowledge that third countries rely on these CCPs and that their financial stability should be taken into account. Therefore, more specific statements that the UK has regard to global financial stability would be a welcome addition.

On a similar note, it would also be helpful to set out, for example via explanatory guidance, how UK authorities will co-operate with the respective foreign authorities in case of a recovery or resolution scenario of a CCP, either in the UK or abroad.

Balance of incentives (1.28)

While we support HMT's objective of designing the resolution tools to balance incentives between clearing members and CCP shareholders, we believe that adjustments must be made to achieve this goal. As currently proposed, the majority of resolution tools target clearing members, through cash calls and the write-down of unsecured liabilities, which taken together are multiples of the members' existing default fund (DF) contributions. Creating such a burden for clearing members relative to CCP shareholders results in the misalignment of risk management incentives and creates potential performance risks for the resolution tools.

CPs are already incentivized to support default management, recovery and resolution given the size of losses they might incur otherwise.

We appreciate that the imbalance in incentives could partially be compensated with an NCWO safeguard. We would like to highlight that loss allocations that are not in line with how losses would be allocated in recovery will however lead to higher NCWO payments overall and a therefore higher risk to the taxpayer.

Instead, we recommend the UK regime to go further in compensation of CPs in recovery and resolution. Compensation should not be limited to losses above any rulebook provisions. When CPs cover the majority of losses and thus in effect enable the CCP to continue operations (whether through recovery or resolution), CPs should at a minimum be eligible to recoup those losses. It would be inequitable if CPs carry most of the losses to support a failing CCP, while future upside from the recovered or resolved entity remain with the CCPs' owners. We propose that CPs that suffer losses from the use of recovery or resolution tools should receive compensation instruments that are not debt based, but senior to CCP equity that would provide holders of these instruments with a claim to future income of the CCP.

Providing compensation in recovery and resolution would also align the incentive structure between these two phases.

Removal of material impediments to resolvability (A.3 ff)

We agree with the additional power although would appreciate further clarity on the nature of changes that the BoE expects to require UK CCPs in order to enhance a CCP's resolvability.

Conditions and timing for entry into resolution and engagement between authorities (A.6)

We agree that the BoE shall be able to enter a CCP into resolution if "*it is likely that the CCP's implementation of the recovery measures will not be sufficient to return the CCP to viability in a timely manner; or the CCP will be unable to apply recovery measures in a manner that does not give rise to significant risks to financial stability."*

Lockdown or deferral period on the payment of dividends, buybacks or variable remuneration (A.13ff)

We agree with this new power but propose that the BoE should start restricting these pay-outs earlier, e.g. at commencement of recovery. Possibly this is what is meant with "*It should be available as an early intervention measure*", but more detail would be required when these restrictions should commence.

Power to suspend termination rights (A.17ff)

We note that in the EU CCP Recovery & Resolution regulation a stay would require a court decision (article 75 (3)). Nevertheless, CCP rulebooks generally have sufficiently long notice periods for a member terminating its membership.

We assume that the term "participation" means "membership". This term should be clarified. We have no concerns if the power to suspend termination rights refers to membership only. Should the rules go further and restrict members' rights of early termination in the meaning of netting rules, we would have potential concerns and would require more details[2].

[2] A typical temporary stay on termination rights provided in a special resolution regime is not problematic because it is assumed that at the end of the stay, the counterparty with the termination right is either left facing a creditworthy institution, or left facing a bankrupt entity with termination rights. The Consultation, however, can be fairly read to suggest HMT contemplates a scenario in which the RA temporarily stays members' termination rights, but after the stay is lifted, such RA could continue to engage in loss allocation. The Consultation states that the suspension of termination rights "*would help stabilize the clearing services offered by the CCP and ensure the Bank has access to the largest possible pool of resources for loss absorbency ....*" If the RA could temporarily stay an exercise of closeout netting, but after the stay is lifted, it could engage in actions constituting a payment failure or other default – then it is difficult to see how this could be squared with the acceptable limitations on closeout netting in existing special resolution regimes that do not prevent (i.e., are consistent with) exposure netting.

Power to take control of a CCP (A.22ff) and the power to remove and replace directors and senior executives and to appoint temporary managers (A.25ff)

We agree with these powers.

Power to restore a matched book (A.27ff)

We generally agree that PTU is the best tool to re-establish a balanced book if primary methods have failed.

We are concerned that "….*where the CCP is unable to independently re-match its book at a price which does not use up an unacceptable level of the loss absorbency available under its rulebook*" at A.28 could mean that the BoE will rely on tear-up if the auction returns a price that is a valid market price but is seen as too expensive.

We welcome the clarification at A.29 that tear-up is not a tool for loss allocation, even though we note that it could be very difficult in resolution scenarios to determine the "*commercially reasonable price*". Given the significance of the price for tear-up we are concerned about and question the appropriateness of allowing the price to be determined by the CCP itself.

For further thoughts on PTU and other position allocation tools, including proposals for further development of PTU please refer to our paper "Partial Tear-Up and Other Position Allocation Tools"[3].

We also welcome that the BoE will provide more details in advance to "*ensure industry understands how any partial tear up will be conducted and how partial tear up would occur in a fair, transparent and non-discriminatory manner*."

There should be two important safeguards on tear-ups:

- Apply to the smallest portion of illiquid contracts possible. Any decisions regarding the scope of contracts to be torn up should be subject to strict governance procedures that are established and disclosed to clearing participants on an ex-ante basis, and account for the views of clearing participants that could have positions torn up. For cleared OTC derivatives, PTUs should never apply only to the contracts that the defaulting clearing member entered into at inception. To this end, we understand why the RA requires the power for a full tear-up but would ask that full tear-up would be only used as a last resort measure. When developing the resolution plan, the RA should also lay out under which conditions and in which scenarios they would use this power, how continuity would be weighed against financial stability and how it would affect a CCP with several clearing segments. We also ask the RA to keep in mind the impact of ancillary services that are required for efficient clearing, for instance compression.

[3] https://www.isda.org/2021/05/28/partial-tear-up-and-other-position-allocation-tools/

- Be priced as close as possible to the fair market value of the torn-up contracts in order to minimize losses to CPs and ensure PTUs do not violate hedge accounting and netting standards[4]. We welcome the reference in A.29 to netting and accounting standards.

No Creditor Worse Off (NCWO) Safeguard (A.34ff) – Covers question 1

We welcome the introduction of a NCWO safeguard for CCP resolution. We especially welcome HMT's restriction of the cost assumed in the counterfactual to only direct cost which creditors would have experienced under the counterfactual. Other cost, like re-hedging cost or cost of clearing at a new CCP would be extremely difficult to estimate as the counterfactual is theoretical by design.

However, we encourage HMT to re-evaluate the appropriateness of extending the NCWO safeguard to CCP equity, as the full application of CCP rulebook in the counterfactual poses challenges in impacting CCP equity and could result in the unintended consequence of paying compensation to a CCP's shareholders.

While we in general welcome the higher level of detail for a discussion of new powers and tools, on the topic of NCWO, the exact implementation of the safeguard and a list of direct cost taken into account will be important for detailed comments on the proposed safeguard.

For instance, the description of the counterfactual is "*should they be left worse off in resolution than they would have been in the absence of resolution action*" at 2.9, but "*what they would have received if, instead of resolution, the CCP had been liquidated under the applicable insolvency law*" in A.34. These descriptions sound similar, but could result in different outcomes, for instance if the RA steps in early for financial stability considerations, despite of the CCP' s ability to allocate all losses in a recovery scenario and therefore would not even enter liquidation.

Please note the following examples of situations where the determination of the counterfactual would be very difficult:

- If the RA commences resolution in order to prevent a CCP from engaging in recovery measures, will the counterfactual require the RA to make assumptions about the possible impact of recovery measures whose exercise is forestalled by resolution?
- What assumptions would the RA make with respect to recovery measures where a CCP has some discretion in the manner of exercise. Would the counterfactual imply full implementation of all of the CCP's recovery measures (up to and including full tear-up and segment or even full CCP closure) followed by the CCP's insolvency?

[4] For further information please see out ISDA Accounting Committee White Paper "Consideration of Accounting Analysis for CCP Recovery and Continuity Tools" at https://www.isda.org/a/LEiDE/isda-accounting-committee-ccp-recovery-tools-white-paper-oct-13-2015-final.pdf

- If the RA commences resolution because there are doubts about the enforceability of the CCP's recovery measures, would the counterfactual still be full implementation of those same recovery measures? In particular, where application of a recovery tool is dependent both on discretionary application by the CCP and further acceptance by members (for instance in the case of ballot-based cash calls) it could be highly contentious for the RA to make assumptions that the tool would have been applied in the absence of resolution action[5].

Deviation from a CCP's rules and arrangements (A.40ff)

While a RA should follow the rules of the CCP's rulebook as much as possible, we agree that it can be necessary that the RA deviates from the set rules. We welcome that these deviations would be covered by the NCWO safeguard.

Second tranche of Skin in the Game (A.45 ff) – Covers question 2

We have long advocated for a second tranche of SITG and welcome the inclusion of the tool in these enhanced powers. Calibration of a second tranche of SITG is technically complex and we look forward to engaging with the BoE on the criteria and methodology for sizing the second tranche of SITG in due course.

We believe that a CCP should expose a significant and dynamic part of its capital as part of the default management waterfall. Under HMT's proposal, the second tranche of SITG would be based on the size of the first tranche. The first tranche is based on calculation methodology under the UK's onshored version of EMIR that is not sensitive to the quantum of cleared risk. In order to align incentives between the CCP owners and CPs, SITG should be based on a percentage of the full default fund and/or linked to the default fund contribution of the largest clearing members. The sizing of default fund reflects the level of business and risk a CCP has chosen to take on and so a calculation based on a percentage of the default fund or the contributions of the largest members is appropriate from the perspective of both aligning incentives and ensuing fairness in loss allocation. Many clearing participants ask for SITG to be set at a minimum of 8% and 10% of default fund or higher. More work on calibration needs to be done. This calibration could include other factors like products being cleared or margin period of risk applied by the CCP.

[5] For unused tools that would be dependent on member approval under recovery we believe the RA should be required to make a default assumption that the tool would not have been applied, unless the conditions for application have already been met at the exact point the RA steps in (for instance if a successful ballot has been completed but a resultant cash call has not been executed).

We propose that the second tranche should be at minimum the size of the first tranche, given that UK CCPs are all globally systemically important. The second tranche should be pre-funded.

Sizing the second tranche of SITG at least as large as the first tranche is especially important as UK CCPs are not on the forefront of SITG as percentage of the funded default fund:

CCP	Country	SITG (before DF) in USDm	DF in USDm	Ratio SITG/DF
B3	Brazil	127	146	87%
HKEX HKCC	Hong Kong	47.94	124	39%
HKEX SEOCH	Hong Kong	26.76	103	26%
CCIL Rupee Derivatives (MIFOR)	India	4.77	19.55	24%
CCIL Forex Forwards	India	138	566	24%
CCIL Rupee Derivatives (MIBOR)	India	19.87	81.52	24%
SGX-DC	Singapore	68.11	285	24%
HKEX HKSCC	Hong Kong	109	707	15%
ICE US F&O	US	68	664	10%
HKEX OTC Clear	Hong Kong	19.35	237	8%
ICE EU F&O	UK	187	3214	6%
CME IRS	US	150	3392	4%
Eurex Clearing	Germany	246	5568	4%
KRX Listed Derivatives	South Korea	36.75	845	4%
ICE EU CDS	UK	50.24	1403	4%
CME Base	US	100	4654	2%
ICE Clear Credit	US	50	2870	2%
LME	UK	21.83	1279	2%
OCC	US	132	9896	1%
JSCC IRS	Japan	19.41	1799	1%
LCH ForexClear	UK	12.89	1201	1%
LCH SwapClear	UK	83.82	8189	1%
LCH RepoClear	UK	10.92	1067	1%
CDCC	Canada	3.93	1835	0.2%
JSCC ETP	Japan	181	4277	0.2%

Source: Fields 4.1.1 and 4.1.3 of CCPs public quantitative disclosures

Variation Margin Gains Haircutting power (A.54)

We agree that VMGH is a tool the BoE should be able to use, including as a separate tool without having to rely on a CCP's rulebook provisions. However, VMGH may not be suitable for all products and could be procyclical and destabilizing without the right restrictions and oversight.

Firstly, we note that VMGH will not be suitable for some products cleared in the UK, for instance repos and cash equities. We welcome further clarification/guidance from HMT which products are or are not suitable for VMGH.

Secondly, we note that VMGH is potentially pro-cyclical and destabilizing. Therefore, additional safeguards are required. It should:

- be used over a minimal time period (i.e., VMGH cannot be used indefinitely).
- apply to all CPs.
- entitle CPs suffering losses as a result of its use to claims.
- Only be applied if the CCP has actually matched its book/or is very likely to do so. This would ensure VMGH does not become a bottomless pit.
- be subject to oversight by (systemic risk) regulators, whether deployed in recovery or resolution.

The RA should aim to using VMGH for the shortest time possible to minimize the losses and impact on the market and financial stability.

To provide context, our members have different positions on the use of VMGH between recovery and resolution:

- Some members believe that due to, among other things, the potentially pro-cyclical and destabilizing nature of VMGH, it should be reserved for use on a very limited basis by the RA.
- Other Association members believe that a CCP should have the flexibility to use VMGH in a limited way in recovery (by duration or amount), subject to regulatory oversight by the CCP's supervisor, and that restricting its use in recovery could result in the need for earlier entry into resolution, which they believe would also be destabilizing.

We welcome the clarification that VMGH should only be used for default scenarios.

Statutory cash call power in a default loss scenario (A.61ff) and statutory cash call power in a non-default loss scenario (A.67ff) – Covers question 3

We understand the requirement for resolution cash calls for default losses. However, we think that the cash call should not be higher than one times the default fund contribution. The further out a cash call is in the waterfall the higher the performance risk.

Provisions in UK CCPs' rulebooks allows the CCP potentially a large number of assessments in recovery under certain circumstances.

Based on our conversations, we understand that HMT expects the resolution cash calls not to be used in addition, but in lieu of assessment in recovery, however there is still a possibility that the CCP has used up all assessments before the RA steps in.

We are also opposed to allowing cash calls of three times the default fund contribution for NDL. NDL stem from risks that clearing participants neither observe, control nor manage and should therefore be for the CCP to cover. Clearing members fund a default fund to mutualise their credit risk, not to mutualise operational risk or other NDL. Such a large resolution cash call for NDL puts too much of the onus on clearing members and violates the principle that incentives and burdens should be distributed evenly across all stakeholders. Using this power will also likely lead to high NCWO claims for clearing members.

We understand the reason that HMT proposes a higher resolution cash call for NDL is because the BoE will not be able to use VMGH, as is the case in the EU regulation. However, given the proposed ability to write down liabilities which would include the funded default fund, we question the need for additional cash calls for NDL.

Finally, we do not agree that cash calls should be used to recapitalise the CCP; prima facie we believe that CCPs should be required to plan ex-ante for recapitalization. One approach would be to issue long term debt instruments that are available for write-down and can be used for recapitalization. In any case, we believe that the authorities should exhaust all other options (sale of the CCP, voluntary recapitalisation) before relying on cash calls to recapitalize the CCP. Further, if CP' funds are used for recapitalisation, i.e. clearing participants provide capital for the CCP, they should also become the owner of the CCP. We understand that such replenishment would be covered by the NCWO compensation.

We however believe that in this case, the safeguard would not always achieve the intended goals:

Numerical example

To demonstrate that NCWO compensation does not always protect members who recapitalised the CCP, we consider a CCP with the following waterfall:

Step	Amount
Initial margin (bankruptcy remote)	1000
DF	100
Assessments	100
VMGH	Depends on scenarios below
CCP equity	50

In the following numerical examples, we assume there is a loss of 300. In an ideal case, clearing members would have a NCWO claim for replenishing the CCP equity. In the first example, the VMGH cap is reached and the CCP does not have non-recourse provisions that would protect equity in insolvency:

Step	Loss Resolution	Loss Counterfactual
DF	100	100
Assessments	100	100
Cash call	50	
VMGH		50
CCP equity	50	50
Replenishment	50	

(blue: loss clearing members, green: loss CCP)

In this example, clearing members would have a loss in recovery/insolvency of 250. In resolution, they have a loss of 300. This would provide for a NCWO claim of 50, the same amount as the replenishment of CCP equity. According to the consultation, this could be paid with CCP equity.

The CCP would not have a NCWO claim, as the losses are the same in resolution and the counterfactual. This is assuming that there are no non-recourse provisions in the rulebook.

This does however not have to be the case. Should the CCP have a higher cap on VMGH, but the RA steps in for financial stability reasons or where the CCP rules have non-recourse provisions (relevant for UK CCPs), the CCP would in recovery use more VMGH instead of insolvency:

Step	Loss Resolution	Loss Counterfactual
DF	100	100
Assessments	100	100
Cash call	50	
VMGH		100
CCP equity	50	
Replenishment	50	

In this case, clearing members would not have a NCWO claim, as their losses in resolution would be the same as in the counterfactual.

The CCP however would have a NCWO claim for the equity that was used in resolution. Resolution action and the NCWO safeguard, together with non-recourse provisions in this example would shield CCP equity from resolution actions. This case could also be seen as

clearing members replenishing the CCP equity, which then would be handed over to the CCP.

The above examples cover default loss scenarios. For NDL, we believe that it is critical that CCPs should hold sufficient equity to absorb potential NDL based on a set of scenarios and predefined framework that determines the appropriate coverage model for various types of NDL, potentially including additional unfunded resources. We recommend additional work on right-sizing CCP equity with NDL in mind and welcome that the Financial Stability Board continues to work on this topic. We also recommend additional consideration of potential unfunded resources that could cover NDL, such as insurance.

As mentioned above under section "Incentives", the proposed structure of absorbing NDL in resolution falls mostly on direct CCP members only. To the extent that right-sized CCP equity is still not sufficient to absorb NDL, we believe this should be equally shared between all stakeholders that benefit from the resolution.

Power to write down and convert unsecured liabilities (A.72 ff)

We agree that the BoE should have this power available for NDL scenarios. We also refer to our comments above that CCPs should right-size their equity for potential NDL to avoid resolution actions for these losses.

We welcome the exclusion of IM from the write-down tool. This however means that the only significant resource to write down will be the default fund, again focussing the majority of loss absorption on clearing members. This will also likely increase NCWO claims.

The only example at A.75 of a liability that could be written down is the default fund. Therefore, we would welcome clarification that the write-down tool applies to all liabilities other than the ones explicitly excluded, for instance also any unsecured liabilities of any parent or other group entity of the CCP itself.

We would further welcome clarification that the write-down tool will not be used to implement VMGH for NDL, where the tools is otherwise excluded.

Power to delay enforcement of a clearing member's obligation (A.80ff) – Covers question 4

We agree in principle with the introduction of a power to delay enforcement of a clearing member's resolution obligation. In certain circumstances, this tool could assist in ensuring a successful resolution, whilst not destabilizing firms that are under stress during the resolution of the CCP. We recommend that delayed enforcement is implemented only in

such a way that it is equitable to all clearing members. This can be done by either delaying enforcement of a tool for all clearing members, or by making sure that clearing members that have paid their obligation are not worse off due to the delayed enforcement. Delayed enforcement should also not delay any NCWO compensation to other clearing members (CM) who satisfied their obligations.

Otherwise, this could create an unhelpful scenario where the most stable CM are penalized. We also ask HMT to carefully analyse the interplay between delayed enforcement and the NCWO safeguard.

For illustration, we consider the following examples:

A CCP has 5 CM and the RA needs to use cash calls of a total of 100, i.e. 20 each. One CM is in difficulties and the RA doubts this CM can pay. The other CM will have to pay 25 each.

Case 1:

The cash calls were in place of recovery cash calls, which would have been the same size, 20 each. The four CM have a NCWO claim of 5 each. We assume the RA will use the proceeds from delayed enforcement to recoup the NCWO compensation. What if this was paid in future profits of the CCP? Will the CCP then receive the proceeds from delayed enforcement?

We also seek clarity whether NCWO compensation would be paid shortly after resolution, or whether the other CMs have to wait for the 18-month period of delayed enforcement to lapse before receiving compensation. 2.16 suggests that compensation can take the form of proceeds from delayed enforcement but is quiet on timing.

Case 2:

The RA has stepped in early. The RA cash call is 20, but there would have been higher assessments in recovery. The four CMs have to pay 25 because one firm cannot pay. As the counterfactual would have been 20, they potentially have a NCWO claim.

The situation is however different if in the counterfactual, the CCP refrains from enforcing the assessment from the bank in resolution and requests higher assessments from the other clearing members. This could lead to these CMs not having a NCWO claim for their higher cash call. Details of the cost in recovery will depend on the CCP's particular rulebook provisions.

Should the situation of the CMs in difficulties be so dire that the counterfactual valuation has to assume that this member would have defaulted, the counterfactual losses could be so large as to not providing any claims for the higher cash calls.

In any case, the firm paying late should cover any interest over the time this firm has not paid its share, regardless of who will receive the proceeds from delayed enforcement. In order to increase the likelihood that the obligations will actually be fulfilled, the period should be increased from 18 months to at least 24 months.

Replenishment (A.83ff)

As mentioned above, we do not agree that cash calls should be used to recapitalise the CCP.

We believe that the RA should not by default look at CMs only for recapitalization. There are other options available that the RA should consider taking into account:

- Third parties willing to buy the CCP, in the process providing capital.
- Use bail-in-able long-term debt to provide pre-funded resources reserved solely for recapitalization.
- A subset of clearing participants agrees to recapitalize the CCP.
- Committed but unfunded capital instruments held by sophisticated, well-capitalized institutional investors unaffiliated with the CCP (which could, but not necessarily need to, include CP)

In any case, we believe that the RA should exhaust all other options (sale of the CCP, voluntary recapitalisation) before relying on cash calls to recapitalize the CCP. If CP funds are used for recapitalisation, they should also become the owner of the CCP.

Clearing member compensation (A.87ff) – Covers question 5

We believe that CP should be compensated by the CCP for losses suffered from the use of recovery and resolution tools. For more information please refer to FIA and ISDA's response to FSB's Consultation on CCP Resources in Resolution.

We however agree that the NCWO principle is an important backstop and applaud HMT that indirect costs will not be taken into account. We agree that there is no credible way to calculate re-hedging cost in a crisis.

As it relates to the form of compensation, some of the potential forms of compensation, for instance the future income of a CCP or CCP equity might be difficult to value. The actual compensation for CPs might therefore be smaller than the NCWO claim. In addition, we disagree with bilateral negotiation on the form of compensation between clearing members and CCPs, as it is not clear that this can achieve the appropriate results given misalignment of interests (see for instance discussion on levels of SITG) and the criteria should therefore be set by the RA. In any case, such negotiations should be ex ante.

We believe that compensation for clients should be mandatory and not left to client negotiations. While we agree this could be contractually achieved, it would be beneficial for the concept of client compensation to be embedded in the regulatory framework in the interest of creating transparency, certainty and thereby creating a market wide level playing field,

We welcome that the consultation foresees cases where CMs are compensated without a NCWO claim. We however think that the example in the consultation at A.97 of a CM voluntarily recapitalising the CCP is slightly unrealistic, as there would be no incentive

whatsoever for CMs to voluntarily provide funds to the CCP in resolution without compensation, for instance in the form of equity.

We note that compensation through means of public funds will be subject to explicit consent from HMT (see 2.16). We request further detail on the circumstances under which this could be withheld and its implications (for instance whether NCWO compensation would not be paid).

Question 6: What lead in time would be appropriate for industry to prepare for the new regime? Are there any elements of the new regime that would not require a lead in time?

Given that changes to CCPs' recovery plans to address issues in the resolvability assessment may require rulebook changes with the attached governance/regulatory process and the time required to draft credible and detailed resolution plans, we propose a timeframe of 18 months in line with the EU regulation.

Question 7: Do you have any other thoughts on the proposals that you would like to bring to our attention

We recommend as much transparency as possible for a resolution plan to enhance member transparency and predictability.

Trade Associations Contacts

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About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 950 member institutions from 76 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.

About FIA

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C.

FIA's mission is to:

- support open, transparent and competitive markets,
- protect and enhance the integrity of the financial system, and
- promote high standards of professional conduct.

As the leading global trade association for the futures, options and centrally cleared derivatives markets, FIA represents all sectors of the industry, including clearing firms, exchanges, clearing houses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry.