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CPSS-IOSCO – Recovery and resolution of financial market infrastructures – Consultative report – July 2012

Dear Sir or Madam,

2012-09-28

We welcome the opportunity to send you our comments concerning the recovery and resolution of global systemically important financial market infrastructures.

Our members basically endorse the approach of CPSS and IOSCO to establishing a recovery and resolution regime for financial market infrastructures. Financial market infrastructures provide key services for conducting transactions in financial instruments and are thus essential to the smooth functioning of financial markets. We nevertheless believe that some of the proposals put forward in the report need to be reconsidered. Naturally, we are aware that we are not one of the consultative report's primary addressees. As participants in, and users of, financial market infrastructures, we are, however, directly affected by anything impacting on them. With this in mind, we would like to take an active part in the consultation and comment on the aspects of particular relevance to participants and users.

1. We warmly welcome the objective of ensuring the continued provision for as long as possible of systemically important – and only systemically important – services of financial market infrastructures. Regrettably, however, the consultative report is quiet on what services should be considered systemically important or what criteria should be used to determine their importance. In order not to jeopardise the aim of continued operations, moreover, we believe there should be an awareness not to exclude ancillary services on which the provision of systemically important services depends.

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2. The question of whether or not a financial market infrastructure takes on credit risk (cf. section 3 of the consultative report) is a sound and important criterion for identifying different categories to which different requirements concerning recovery or resolution need to be applied. Such a distinction could also justify the production of different outcomes. In our view, however, it should not be the sole criterion: this would be insufficient, too “black and white” and incapable of taking either adequate or appropriate account of the vast range of different structures underlying financial market infrastructures. True, financial market infrastructures are all alike in that they facilitate and support efficient trading in financial instruments. The issue of credit risk is only one of many major differences between them, however. Financial market infrastructures differ not only in the services they offer, in their business models and in the amount of credit risk they assume. They also have different types of participants, members, users and clients, are based on very different ownership and operating structures, are located in different jurisdictions, and are subject to different requirements, security mechanisms and supervisory authorities. Furthermore, they are connected – or even interconnected – with other financial market infrastructures, financial markets and market participants, all of which may also be affected by the recovery or resolution measures and all of which may also be systemically important. In our opinion, these extensive, wide-ranging differences require equally varied evaluation and treatment, the application of different measures and possibly the acceptance of different outcomes. We therefore see a need for a more extensive breakdown into categories for CCPs, CSDs, SSSs, TRs, payment systems and “others”. Even within these categories there will be a number of specificities and variations needing to be adequately taken into account. There will also be some overlaps; for instance, if a CSD operates a SSS.
3. If credit risk is used as a criterion, it will be important to take account of differences in the sources of credit risk and the ensuing consequences. Losses arising from a financial market infrastructure’s business model should be treated and allocated differently to losses arising from bad investments, unexpected costs or operational losses, for instance. In paragraph 3.10 ff., the consultative report rightly addresses the question of who should absorb how much of a CCP’s losses in the event of a defaulting member, what mechanisms should be used and how a matched book can be re-established. The report does not consider how to deal with an ailing CCP whose difficulties were caused by bad management or other factors unrelated to a member’s default. It is nevertheless clear that different recovery and resolution measures would have to be applied in each case.
4. When considering the recovery or resolution of financial market infrastructures which take on credit risk, the consultative report seems to focus primarily on CCPs. Paragraph 3.10 nevertheless states that other types of financial market infrastructure also have a “waterfall” to determine the order of loss absorption. We are not aware of any such waterfall provisions.

We are concerned about the proposed loss allocation solutions in paragraphs 3.13 and 3.14 (e.g. haircuts of variation margins) since they could compromise protection and security mechanisms (such as the waterfall) which are supposed to avoid crises in the first place. Although the proposed haircut refers to in-the-money participants, this may be only one of various possible solutions (others might include auctions, haircuts, default funds, top-up or replenishment of protection funds, extraordinary, additional or enhanced payments, limits, etc.). These possible solutions should first be developed and then discussed in depth with affected parties.

In addition, we would welcome a **general clarification** that, when realised losses are allocated, **none** of the CCP's protection and security mechanisms relating to member defaults may be utilised (nor, should they exist, equivalent mechanisms of other financial market infrastructures). Otherwise,

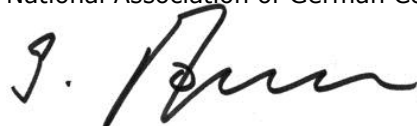
- a) the viability of the financial market infrastructure and
- b) market participants

would be jeopardised and there would be a risk of **system-wide contagion**. For the same reason, we firmly reject the idea raised in the question following paragraph 4.14 that the bail-in tool should be available to collateral and margin (including initial margin). At most, only claims on the default fund could be available for bail-in.

5. We would welcome the chance to take part in further discussions about alternative solutions and aspects of loss allocation, especially possible end-of-the-waterfall procedures. We would like to suggest that the recommendations and ideas of all affected parties are included in deliberations – not just the financial market infrastructures themselves together with supervisors and lawmakers, but also direct and indirect participants, members, users, customers, owners and operators.
6. We appreciate that CPSS and IOSCO wish to interpret the FSB's Key Attributes for use in the resolution of financial market infrastructures, particularly since the Key Attributes are familiar and widely accepted. It should nevertheless be borne in mind that these recommendations were primarily designed for banks. If an attempt is made to transfer and possibly adapt them to financial market infrastructures, there is a danger that numerous characteristics and specificities will not be adequately taken into account. Paragraph 4.6 ff. of the consultative report rightly points out that some measures recommended in the Key Attributes may lend themselves to bank resolutions but are not suitable in the same form for financial market infrastructures. Such measures include, in particular, moratoria and bail-ins. The transfer or adaption of these measures to financial market infrastructures would therefore throw up numerous questions. A more appropriate and reliable solution, in our view, would be to develop a separate, specially tailored regime for the orderly resolution of financial market infrastructures which took account of their differences and special characteristics compared to banks. Naturally, this regime could be based on the FSB Key Attributes. It should also, if possible, deal with the as yet unaddressed question of the impact which the resolution of one financial market infrastructure may have on another which is part of the same group or even part of the same company.

We would like to thank you once again for the opportunity to comment on the report and would naturally be happy to provide further information or discuss any of the issues raised in our response. Please feel free to contact Mr Diedrich Lange for any queries on these comments.

Yours faithfully,
on behalf of the German Banking Industry Committee
National Association of German Cooperative Banks



Gerhard Hofmann

by proxy

Dr. Diedrich Lange

