BLACKROCK

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Committee on Payment and Settlement Systems Secretariat
Bank for International Settlements
4002 Basel
Switzerland

International Organization of Securities Commissions Secretariat
C/ Oquendo 12
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Spain

Submitted via email to cpss@bis.org and fmirecovery@iosco.org

BlackRock Response to the CPSS-IOSCO Consultative Report on Recovery of Financial Market Infrastructure (August 2013)

Dear Sirs,

BlackRock[1] welcomes the opportunity to respond to the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO) Consultative Report on Recovery of Financial Market Infrastructure (the "Report").

At the outset we note that BlackRock responded to the CPSS-IOSCO 2012 consultation on resolution and recovery of Financial Market Infrastructures (FMIs) and more recently provided its preliminary views on the Report. [2] We appreciate that recovery planning is an important exercise for FMIs so as to provide market participants with information on how each FMI may approach recovery, and to avoid ad hoc decision-making during a crisis event. However, we believe that the regulatory focus and goal should be rapid resolution. Financial stability is best served by a regime that focuses on a rapid and complete winding-down of the failing CCP's positions and a timely and orderly repayment of margin monies rather than trying to ensure the continuity of clearing services.

[1] BlackRock is a leader in investment management, risk management and advisory services for institutional and retail clients worldwide. At 30 June 2013, BlackRock's AUM was $ 3.86 trillion (€ 2.96 trillion). Our client base ranges from sovereign wealth funds and official institutions to financial institutions, foundations, corporations, charities and pension funds. The mainstay of our client base is represented by pensioners and savers. BlackRock pays due regards of its clients' interests and it is from this perspective that we engage on all matters of public policy. BlackRock supports regulatory reform globally where it increases transparency, protects investors, facilitates responsible growth of capital markets and, based on thorough cost-benefit analyses, preserves consumer choice.

[2] Recovery of Financial Market Infrastructure, CPSS-IOSCO (22 August 2013) http://www.blackrock.com/corporate/en-us/literature/publication/fmi-recovery-cpss-iosco-082213.pdf; Resolution and Recovery of Financial Market Infrastructure, CPSS-IOSCO (28 September 2012), http://www.blackrock.com/corporate/en-us/literature/whitepaper/recovery-and-resolution-of-financial-market-infrastructures-cpss-iosco.pdf. We also plan to respond to the Financial Stability Board Consultative Document on Resolution of FMIs issued 12 August 2013.

We appreciate the opportunity to address and comment on the issues raised by the Report. We are prepared to assist CPSS and IOSCO in any way we can, and welcome continued dialogue on these important issues. Please contact any of the undersigned if you have comments or questions regarding BlackRock's views.

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BlackRock Response

Recovery of financial market infrastructure (FMIs) –Consultative Report August 2013

1. All FMI's, including CCPs, should be sufficiently capitalized so as to avoid failure, and where failure is not avoidable, to fail without causing systemic risk. The overall regulatory goal should be to reduce the likelihood of a CCP needing to be resolved, but if resolution is necessary, to minimize losses in resolution.

2. Recovery planning has salutary effects as it forces the CCP to map the financial, operational and other aspects of maintaining its services and such a plan should eliminate or reduce the risk of ad hoc decision-making during a crisis. Market participants may also benefit from understanding the CCP's plans, especially as to what rights and obligations each CCP believes its various market users possess. That said, financial stability is best served by a regime that focuses on a rapid and complete winding-down of the failing CCP's positions and a timely and orderly repayment of margin monies rather than trying to ensure the continuity of clearing services. We do not believe that maintaining the continuity of services by any one CCP is critical to avoiding the next financial crisis.

3. We believe that one of the recovery tools as contemplated in the Report, that of a transfer of positions or the use of a transferee CCP to provide clearing services is as a practical matter illusory and will be harmful to end-users. We note that currently there is no fungibility of contracts and no process for portability of positions between CCPs.

4. We are skeptical that another CCP could be found that was willing to assume all the positions of the failing CCP, and certainly not without extensive diligence. Further, based on limited transparency as to risk management at CCPs, we do not believe that CCPs have stress tested the scenario where they may be the receiving counterparty of positions held at another CCP. The potential transfer of positions poses risks to the receiving CCP, and could contribute to contagion effects, further de-stabilizing FMIs and other market participants.

5. We believe that the use of customer margin for loss absorbency is antithetical to the goals of the G-20. As we understand it, the purpose of central clearing is to reduce systemic risk and to protect end-users and taxpayers. End-users are pension funds, retirement, insurance, and other saving vehicles of hundreds of thousands of individuals. Official sanctioning of the use of customer collateral to prop up a CCP will impose losses on these "saver-taxpayers" and runs counter to the objectives of central clearing. Further, in those jurisdictions where swaps clearing is mandated for all market participants, end-users may, consequently, decide to minimize their use of – or avoid transacting altogether in those swaps, resulting in significant reductions in the use of swaps and suboptimal risk management or no risk management at all.

6. CCPs should be required to increase their own capital to create a larger buffer against events, such as clearing member default, that could endanger the financial viability of a CCP. This will enforce and encourage robust risk management at the CCPs. This capital could take the form of additional equity or debt issuance structured to act as a bail-in layer of capital. We note that capital rules recently enacted by banking regulators will now require that banks hold capital against CCP exposure, an acknowledgement that CCP exposure is no longer considered zero RWA. These additional steps to capitalize a CCP will promote confidence with market participants that customer margin will not be required for loss absorption.

7. Haircutting collateral of indirect participants (customers of clearing members) unfairly imposes the costs of recovery and failed CCP risk management on entities that did not contribute to the losses or default and do not have the opportunity, access and/or ability to assess or significantly influence the risk management of the CCPs.

8. Recovery that includes the ability to haircut customer margin will be pro-cyclical, especially given the limited insight that indirect participants have into the financial health of the CCP. As soon as it appears that a CCP may be in difficulty, these customers will terminate their positions. Buyside firms, as fiduciaries for their clients, will act to preserve client assets, preferring to be “money good” rather than “position good”.

9. Those market participants, such as clearing members and their affiliates, with superior information and earlier indications as to the financial condition of the CCP will exit sooner, increasing the probability that customers will end up with greater losses.

10. That a failing CCP could be recovered at all disregards the impact of the loss of confidence by market participants will have on the liquidity of the CCP. There will be no confidence in the services and functions of a failing CCP. Customers of clearing members will not establish new positions that require clearing at a failing CCP where there is a probability of loss of their collateral. This will be true even if the failing CCP is the only CCP that clears that particular product. End-users will forgo risk management activities where clearing is required, or seek alternative instruments for desired market exposure or remain in cash. This also underscores the need for competition in the form of more than one CCP to clear the same product.

11. The purpose of the rapid liquidation of positions would be to close-out the clearing business very quickly and to return margin provided by non-defaulting clearing members and their non-defaulting clients with minimum market loss. A rapid liquidation and return of margin would minimize end-user losses and would allow clearing members and their clients the option to establish replacement positions in the most efficient manner.

12. It is important that liquidation be swift and orderly with ex ante defined procedures to minimize the size of loss and provide certainty to participants of risk exposure and that they are money good.

13. Immediately after a default where a CCP does not have the financial resources to sustain itself, the CCP will be risk neutral with a matched book, except for defaulted positions. A parallel process of tearing up matched positions, which is likely a substantial majority of the CCP portfolio, and holding an auction for unmatched positions should be implemented at that time. The “tear up” price must be established immediately as delay will increase volatility and losses. We also recommend that auction participants should be expanded to include clearing members as well as other market participants who are judged able to honour their bids. A larger number of auction participants and open participation would result in a more transparent process and result in a more fair and accurate market price.