

CPMI Secretariat
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

By email: cpmi@bis.org

Zurich, 18 October 2016

Re: UBS response to the CPMI-IOSCO consultative report: Resilience and recovery of central counterparties (CCPs): Further guidance on the PFMI

Dear Sir/Madam

UBS would like to thank the Committee on Payments and Market Infrastructures for the opportunity to respond to the consultative report. Our response should be considered complementary to the Joint Associations' response¹ to which UBS contributed and which UBS supports. With this letter, we would like to stress certain key considerations on important aspects of CCP resilience and resolution.

Objective of CCP resolution

- We would like to emphasize that we view CCP resilience as key and that we believe that CCP methodologies and procedures need to be sufficiently robust to manage current and stress credit exposures in order to ensure that the necessary financial resources are available to reduce the probability that a CCP would need to enter recovery and resolution. In this regard, we believe that the PFMI would benefit from more granular and robust recommendations regarding the margin and stress methodologies including greater transparency and disclosure requirements. Additionally, we are of the view that a "2x cover requirement" should be set as a standard across all CCPs and that CCPs should be encouraged to always operate at a reasonable margin above the minimum requirement. We also believe that CCP cover requirements must be set under consistent scenarios applied by all CCPs.
- Although we are supportive of the objective to maintain the continuity of the provision of central clearing services, we do not share the view that continuity of service of a CCP must be ensured under all circumstances as part of an orderly CCP resolution regime. While continuity should be the preferred resolution approach, the plans must provide for an orderly wind-down of a CCP's clearing services where continuity, although desirable, cannot be reasonably expected to be achieved or cannot be achieved without unacceptable consequences for financial stability. Orderly wind-down should be limited to circumstances in which the CCP, or the relevant clearing service, is no longer systemically important, the market it supports no longer requires continuity, or continuity cannot be achieved (i.e. a CCP has no prospect of a matched book or a critical mass of clearing members would be unwilling to continue participating in the clearing service).

¹ Joint Association response by the The Futures Industry Association (FIA), the Institute of International Finance (IIF), the International Swaps and Derivatives Association (ISDA), the Clearing House (TCH), and the Global Financial Markets Association (GFMA).

Resolution strategies

- We support the view that CCPs should be required to prepare resolution plans (i.e., 'living wills') for their orderly resolution based on standards prescribed by the relevant authorities. Resolution authorities, in consultation with other competent authorities, should also prepare public sector 'playbooks' or 'action plans' for the orderly resolution of CCPs generally and, where appropriate, individually, as a supplement to each jurisdiction's overall resolution framework. These CCP resolution plans should be made available to clearing participants, subject to protection of confidential content.
- The decision whether to place a CCP in resolution should be entrusted to the home country resolution authority in consultation with the CCP's supervisory regulator (or, if applicable, the CCP's supervisory college) and the home country systemic risk regulator.
- Following a member default we clearly prefer a predictable process based on the rule book. However, we recognize that regulatory authorities should retain a degree of flexibility to challenge the order of the rule book should this allow it to maintain market stability and continuity. Regulatory authorities, however, should carefully consider the impact of any intervention specifically on financial stability, its potential impact on the CCP and its clearing participants, and other potential risks. In this context, we would welcome more clarity in regard to the point of regulatory intervention including more quantitative and qualitative regulatory triggers based on the point prior to which a CCP is approaching non-viability (i.e. financial resources coming close to exhaustion, failed auction, or loss of confidence in CCP).
- In the event of the exercise of assessments / cash calls, partial tear-up, variation margin gains haircutting or any other recovery and resolution tool that allocates losses to non-defaulting clearing participants, the CCP or another entity in resolution should be required to fully compensate the affected clearing participants through the issuance of a debt instrument eligible for bail-in in resolution. This compensating instrument (if not bailed into equity) should be repayable via recovery on the CCP's claims against the estate(s) of the defaulting CM(s) and future CCP revenues/profits.
- Under no circumstances should initial margin haircutting be permissible in CCP resolution (or by CCPs as a recovery tool). This would potentially have a negative impact on the stability of markets, as members rush to exit a CCP, or CCPs issue replacement initial margin calls during periods of heightened stress, resulting in further member defaults.

Allocation of clearing or non-default losses (NDL) in resolution

- In general we believe that with regards to the allocation of losses in resolution a distinction should be made between circumstances in which a CCP cannot meet its threshold conditions as a result of i) losses directly incurred from its clearing activities and ii) NDL losses incurred via other means (such as losses on its investments).
- Under scenario i), we consider it appropriate that losses are shared between the CCP owners, clearing members, clients of clearing members and general creditors of the CCP. Under scenario ii) however, we believe that overall more harmonization of NDL is required across CCPs including more granular ex-ante rules. Such rules should be based on an incentive structure that should consider the fairness of any loss being assigned. This could include a bespoke recovery and loss allocation process depending on the type of operational loss that has occurred (i.e. individually for the management and control of investment losses, and operational losses resulting in the failure of a custodian and/or settlement bank, and fraud and cyberattacks). We strongly believe that the largest incentive should be set to those that have oversight and control of any process. Therefore if it is the CCP that has control and oversight of a process, losses should be allocated solely to their shareholders. Added to this we ask the FSB to consider whether NDL associated with the performance of other FMI, e.g. custodian and settlement banks, would be better considered as part of their own recovery and resolution plans.

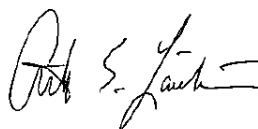
- We are further of the view that the CCP (i.e. its owners) should be the first to have capital at risk once the total default fund contributions have been wiped out. This should create the correct incentives for the CCP to calibrate margins and clearing members' default fund contributions appropriately to reduce the risk of its 'skin in the game' being required to absorb losses and also to ensure that the aggregate default fund is appropriately calibrated so its 'end of the waterfall' capital is not eroded.

We would be happy to discuss with you in further detail any comments you may have. Please do not hesitate to contact us if you have any questions

Yours sincerely



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