

Executive summary

The Financial Stability Board (FSB), in conjunction with the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO), is seeking more effective resolution regimes for systemically important central counterparties (CCPs). This stems from the increasing significance of CCPs to financial stability post the 2008/09 financial crisis. The report emphasizes the need for adequate liquidity and recapitalisation resources along with appropriate tools in resolution scenarios. The FSB, in a qualitative analysis of financial resources and tools, has identified four parameters and six key analytic dimensions that would support CCP resolution objectives. These parameters address loss absorption, CCP recapitalisation, liquidity and other facets such as financial stability and incentives alignment. In understanding the complexity and uniqueness of different resolution scenarios, it is suggested that a toolbox approach is effective in supporting resolution objectives. This approach elevates the flexibility of resolution authorities, allowing them to access different resources and tools, and tailor them to their jurisdiction's requirements. The FSB approaches the implementation of the toolbox approach as a global standard for systemically important CCPs. The global standard indicates two expectations; the accession of resolution-specific resources and tools by home resolution authorities, and a transparent approach by jurisdictions to calibrating the resources in the resolution toolbox. The report underlines the implementation of the toolbox approach through amendments to the FMI annex to the Key Attributes, along with monitoring the application for systemically important CCPs by the FSB. The monitoring outcomes will appear in the FSB's annual resolution report. Overall, the document advocates diversified resolutions, with access to a combination of resources and tools, aiming for risk diversity and reducing undesirable consequences.

1. Introduction and background

This text elaborates on the need for robust resolution measures for systemically important Central Counterparties (CCPs) and available resources to maintain financial stability and public confidence in the financial system. Key advancements have been made to strengthen the resilience and recovery of CCPs, emphasizing the necessity of sufficient liquidity, recapitalisation resources, and tools. Insufficient resources and tools could pose a risk to an orderly resolution of the CCP, potentially destabilising financial stability. Authorities must consider optimal utilization of resolution resources and CCP recovery tools to avert or mitigate such impacts. The Financial Stability Board (FSB) underlines the significance of effectual CCP resolution planning and responding mechanisms, with ample financial resources and equipment to support an orderly resolution. The FSB, in collaboration with the Committee on Payments and Market Infrastructure and the International Organisation of Securities Commissions, analysed the financial recourses for CCP recovery and resolution for default and non-default loss scenarios. The study concluded that pre-funded resources and tools for CCP resolutions offer better assurance of availability during resolution than contingent resources. The report laying out these insights also proposes a versatile approach for resolution resources, summarising the analysis of these mechanisms, findings about these resources and tools, and a framework for their effective implementation and monitoring.

2. Objectives for CCP resolution resources and tools

The objectives of CCP resolution are to maintain financial stability and ensure the continuity of critical CCP functions without burdening taxpayers. The process should encourage entities to actively participate in default management or recovery while reducing the likelihood of resolution. To meet these objectives, resolution authorities must have access to resources and tools that comply with four parameters laid out by the Financial Stability Board based on the Key Attributes: A) Provision of sufficient loss absorption, reassessment options, and liquidity for achieving a successful resolution. B) Availability of reliable resources promptly in resolution. C) Mitigation of potential adverse impact on financial stability. D) Alignment of incentives across recovery and resolution processes and achieving consistent outcomes by means such as ensuring CCP equity remains primary loss and preserving stimuli for market participants to participate in recovery and central clearing.

3. Scope of analysis on resolution resources and tools

The analysis delineates seven financial resources and tools for Central Counterparty (CCP) resolution: bail-in bonds, resolution funds, resolution-specific insurance, third-party contractual support, resolution cash calls, variation margin gains haircutting (VMGH), and equity write-downs. Bail-in bonds are subordinated or unsecured junior-ranking debts issued by CCPs for recapitalisation or resolution loss absorption. They could be converted into equity or other forms of ownership interests when a resolution scenario materialises. Resolution funds are pre-funded resources that can be called upon in resolution scenarios. These funds are independent of individual CCPs and could either be national or supranational, with governance structure and design input from all resolution authorities who are eligible to use its resources. Resolution-specific insurance contracts provide coverage for certain risks so that financial resources can be availed during CCP resolution. Similarly, third-party contractual support provides contingent resources from a third party for use during resolutions. Resolution cash calls enable resolution authorities to secure funds from clearing participants once a CCP is placed in resolution. Variation margin gains haircutting (VMGH) gives authorities the separate right to delay, reduce, or cancel variation margin payments in resolution. Equity write-down is the resolution authority's power to use existing CCP owners' equity to absorb losses in a resolution scenario. The Financial Stability Board (FSB) advises resolution authorities to have specific legal authority to use any remaining, non-exhausted tools in recovery and not rely solely on resources designated for recovery. However, designated resolution tools should comply with the standards outlined in Section 4 for CCP resolution resources and tools. The FSB also reflects on the importance of temporary public funding to facilitate resolution, emphasising that it should only be used when private sources have exhausted and must be in the interest of fostering financial stability. It further encourages strong cost recovery powers to ensure moral hazard around its usage is minimised.

4. Qualitative analysis

The Financial Stability Board (FSB) executed a qualitative analysis of selected financial tools and resources across six analytical dimensions which encompass resolution resource parameters. These were laid out in Section 2 and align with the goals of a Central Counterparties (CCP) resolution. The analytical dimensions correspond to the resolution resource parameters and are outlined in Sections 4.1 and 4.2 with examples of their relevance. Key analytical dimensions include: Purpose and Usability; Timeliness and Performance Risk; Legal and Operational Considerations; Impact on Financial Stability; Cost - Magnitude and Allocation; and Impact on CCPs' business models and clearing participant incentives. These are evaluated in relation to their ability to provide loss absorption, CCP

recapitalization options, and liquidity, and to mitigate potential adverse effects on financial stability among other things.

4.1. Analytical dimension analysis

The text discusses a detailed analytical dimension analysis. In Dimension 1, the analysis examines the purpose and usability of a resource or tool, considering their capabilities for loss absorption, recapitalisation, and liquidity in CCP resolution during both DL and NDL scenarios. It also evaluates the resource's availability and scalability to meet resolution needs. Dimension 2 and Dimension 3 probe the reliability, availability, performance risk, legal considerations, and operational concerns of the resources for resolution. They focus on the resource/tool's readiness for resolution, potential legal impediments, and operational aspects affecting the resource/tool's establishment, maintenance or access. Dimension 4 evaluates the potential impact of the resources or tools on financial stability. It analyses whether the resource/tool would create adverse effects for financial stability, pre-funded vs unfunded commitment, predictability of the resource provision and the identity of the source of resolution resources or tools. Lastly, Dimension 5 & 6 analyse the costs, impact on CCP's business models and clearing participant incentives. It takes into account the financial burden of providing the resource or tool and its allocation among parties while evaluating its alignment with recovery and resolution incentives. It also assesses the resource/tool's implications on CCPs' business models and its impact on participants' incentives in default management and recovery.

4.2. Dimension analysis and comparison of resources and tools

The analysis of resolution resources and tools for a Central Counterparty (CCP) highlights their diverse features and potential drawbacks without attempting to rank their value. The resources and tools studied include bail-in bonds, resolution funds, resolution-specific insurance and third-party contractual support, resolution cash calls, statutory or contractual VMGH (Variation Margin Gains Haircut) for resolution and equity. Bail-in bonds offer recapitalisation options, liquidity maintenance and loss absorption but their large costs can challenge CCP businesses. The implementation of resolution funds involves multiple challenges including the complex legal implementation process and procedural considerations but they can potentially cover large losses or high liquidity needs efficiently. Insurance and contractual third-party support may lack timeliness, legal and operational certainty depending on their design. Resolution cash calls can cause financial instability in a systemic crisis scenario. VMGH can provide loss absorption and liquidity but challenges arise when determining its sufficiency in non-default loss scenarios. Equity write-down can satisfy some resolution resource parameters but may not be available in sufficient amounts post-recovery. In view of the pros and cons of these resources and tools, the Financial Stability Board did not prioritise any parameter or analytical dimension over others in achieving the objectives of resolution. Overall, the analysis shows that using a combination of complementary resources and tools can be advantageous.

4.3. Implications of different compositions of resources and tools

The text discusses the importance of a combination of resources and tools to achieve resolution parameters, as no single resource or tool can meet all objectives. These resources and tools provide resolution authorities with the flexibility to respond to distinct circumstances and market conditions in the backdrop of jurisdiction's legal regime and related CCPs. The text further considers these resources and tools in the context of the four resolution resource parameters. It emphasizes the need for liquidity, recapitalisation, and loss absorption resources that are readily available for supporting orderly resolution. The use of these resources should consider impacts on financial stability in idiosyncratic and systemic crisis situations. Various factors such as the nature of products cleared across CCPs, circumstances leading to DLs or NDLs, and concentration of participants across CCPs must also be regarded. The resolution authorities' legal and operational abilities could affect the choice of specific resolution tools. Parameter D discusses the effects of the composition of the resolution toolbox on the CCP, clearing members, and market participants. The text underscores the importance of aligning incentives across recovery and resolution, considering the magnitude and allocation of costs, and supporting cooperation in default management and recovery. Resources and tools should complement each other, with implications of different toolbox compositions evaluated to meet each resolution parameter and dimension. The text delves deeper into Parameters A-C, discussing the necessity of having dedicated resources and tools for liquidity, loss absorption, and recapitalisation. The parameters consider dimensions like purpose, usability, reliability, minimal legal and operational risks, and potential adverse effects on financial stability. Parameter D sheds light on aligning incentives across recovery and resolution while ensuring outcomes in resolution are consistent with the Key Attributes.

5. Framework for resolution resources and tools

5.1. A toolbox approach

The adequate availability of financial resources and tools is crucial for the effective resolution of a systemically important CCP. A lack thereof may cause a significant negative impact on financial stability. Relying solely on recovery resources might not be effective, as the resolution could fail if recovery fails. Hence, having a range of resolution-specific resources and tools is vital. A toolbox approach offers flexibility to resolution authorities, allowing them to choose suitable resolution-specific resources and tools while taking into account the costs and benefits of each option. This approach does not specify a quantum to be available for resolution but leaves each jurisdiction to establish its own calibration of resolution-specific resources. Finally, diversifying through accessing a combination of resources and tools can mitigate the risks associated with reliance on a single tool or resource and achieve desired benefits in resolution.

5.2. Contents of the resolution toolbox

The resolution toolbox includes resolution-specific resources and tools and financial resources from non-exhausted recovery tools if applicable. The toolbox should accommodate varying parameters and circumstances by featuring diverse, resolution-specific resources. The resolution authority's legal ability and operational capacity to intervene and use recovery tools can dictate their choice and calibration of resources. Seven potential components of the toolbox include bail-in bonds, various resolution funds, resolution-specific insurance and

support, resolution cash calls, contractual VMGH for resolution, and equity in a first-loss position. Temporary public funding should only be utilized as a last resort.

5.3. Implementation of the standard

The FSB is discussing implementation of a global standard for a resolution-specific toolbox approach. The standard features two main parts: an expectation that resolution authorities of systemically significant CCPs have access to resolution-specific resources and tool meeting certain objectives, and that home jurisdictions should make transparent their calibration methods for these tools and resources. It's suggested that the standard will be incorporated into the FMI Annex of the Key Attributes. This would include a specific legal authority for resolution authorities to utilise non-exhausted tools and resources that are available to the CCP in recovery, and the power to intervene before these have been fully used. The resolution toolbox should also be designed in line with specified standards. The resolution-versatile resources and tools should meet certain criteria, such as reliability, potential to stabilise adverse financial effects, and alignment with the Key Attributes. The toolbox may include bail-in bonds, resolution funds, and statutory or contractual VMGH for resolution among others. The composition of these resources and tools may be reviewed and enhanced by the FSB as deemed fit. In the future, assessing the adequacy of resources would be conducted within the context of the resource standard set out in the Key Attributes.

5.4. Ongoing monitoring

The FSB will conduct ongoing monitoring of the implementation of the standard for SI>1 CCPs using its established CMG and RAP questionnaires. These tools supplement each other in monitoring resolution planning and assessing advancements by resolution authorities, also offering insight into related CMG dialogues for SI>1 CCPs. The outcomes are included in the FSB's annual resolution report, providing clarity on cross-border resolution discussions, data sharing protocols, and firm resolvability evaluations. This system will, thus, deliver continuous transparency on the resolution toolbox's implementation for SI>1 CCPs.