ISDA and FIA response to the RBA's consultation on the Guidance for the Australian Clearing and Settlement Facility Resolution Regime[1]

Executive Summary

ISDA and FIA (together, "the Associations"), appreciate the opportunity to comment on the draft Guidance for the Australian Clearing and Settlement Facility Resolution Regime (the "draft guidance").

The Associations very much welcome the publication by the Reserve Bank of Australia (RBA) of a guidance "intended to provide further information about when and how the RBA would generally expect to use its resolution powers", as set out in the introduction of the document. In the response to the FMI regulatory reforms bill[2], the Associations expressly called for the RBA to provide as much clarity and transparency as possible on the tools it would use in a resolution scenario, including details on calibration of resolution tools, on the approach to recapitalization, as well as on compensation. We applaud the RBA's initiative and appreciate that the RBA has taken into consideration those comments in developing this guidance. The Associations have carefully considered the provisions set out in the draft guidance, and welcome the opportunity to provide comments.

The structure of our comments follows the structure of the guidance.

Comments on section B: "An introduction to Clearing and Settlement facility resolution"[3]

In its description of its approach to conducting resolution, the RBA notes in paragraph 24 that it will "seek to communicate with stakeholders in an open and timely way to the extent that this is consistent with the resolution objective". It would be helpful to further define in this guidance the stakeholders that the RBA intends to communicate with, to provide greater certainty, in particular to clearing members, as to when and how they would be kept informed by the RBA on the progress of resolution proceedings. Also, the RBA doesn't specify when and how it will communicate with relevant stakeholders prior to entry into resolution, and how it would intend to signal entry into resolution.

Comments on section C: "Key principles guiding the use of resolution powers"

We welcome that the RBA has developed a set of key principles that would guide its use of resolution powers. We note that one of those key principles sets out that "the RBA must maintain flexibility in the use of resolution powers", noting that it cannot "set out definitively the steps that it will need to take". We appreciate that, as the RBA also notes,

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[1] Guidance for the Australian Clearing and Settlement Facility Resolution Regime.

[2] FIA-ISDA-joint-response-to-Australia-FMI-regulatory-reforms-consultation-final.pdf

[3] We appreciate that the guidance is relevant for the resolution of clearing and settlement facilities, but our response focuses specifically on powers related to CCPs.

crises are unpredictable, such that flexibility is valuable for resolution authorities to react to a crisis scenario. We would also welcome the acknowledgment, in this principle, that the RBA, while maintaining flexibility, should seek to ensure the maximum level of predictability for market participants, by sticking as closely as possible to the approach set out in the guidance.

We would also welcome explicit reference, as part of the key principles, of how the RBA intends to consider the financial stability consequences of its resolution actions through the impact that they may have on market participants, considering in particular the procyclical nature of tools which may be part of the rules and procedures of the CCP – and which we understand that the RBA might therefore use – such as variation margin gains haircutting and cash calls. In addition, in the FSB report on financial resources and tools for CCP resolution, financial stability is also included as a "resolution resource parameter" and "analytical dimension" in the qualitative analysis of the CCP resolution tools.[4] In light of this, the Associations consider that the RBA should include more explicit consideration of financial stability in its set of key principles, considering financial stability in all its dimensions – i.e. including the impact that the use of resolution tools may have on market participants.

We would suggest that the RBA also have regards to compensation of clearing participants that have borne losses in resolution (through the use of remaining recovery tools in resolution), to ensure that any funds drawn from clearing participants (members and clients) for resolution purpose entitles them to compensation, in line with the "no creditor worse off" principle set out in the FSB Key Attributes and 2017 Guidance on CCP resolution.

Relatedly, with regards to recapitalization, we note that future ownership of the CCP should be assessed across all resources provided in resolution, and in light of any compensation in the form of ownership instruments that may be issued to clearing participants.

Comments on section D: "Entry into resolution"

We welcome the consideration of the interaction between recovery and resolution. We note that the RBA explains the scope of its non-resolution powers, which includes the ability to direct a CCP "to do, or refrain from doing, a specified action under its recovery plan". In addition, in considering the conditions for entry into resolution, the RBA notes that "key scenarios where resolution powers might be used are when the CS facility's efforts to maintain viability could destabilise other parts of the financial system and where the CS facility's recovery plan and arrangements prove inadequate or ineffective due to the nature of the threat". We welcome this approach to triggering resolution "before it is too late", as a protracted and unsuccessful recovery process would have damaging consequences on market participants, considering that the comprehensiveness of the tools available in recovery (as a result of the expectations set out in the CPMI-IOSCO guidance on recovery of financial markets infrastructures[5]) means that exhausting all available tools in recovery could have significant consequences for clearing participants. In setting out when it would

[4] Financial Resources and Tools for Central Counterparty Resolution
[5] Recovery of financial market infrastructures

consider using a resolution power, in paragraph 37, the guidance includes some examples, such as if "the RBA reasonably believes the CS facility's recovery plan and arrangements are not adequate or appropriate to address the threat to the CS facility's viability". While we agree with this principle, it would be helpful if the RBA could set out in further detail what this "reasonable belief" might be appreciated. As an example of what further detail could look like, we note that in the UK regime, the CCP resolution code of practice, published by HM Treasury, sets out a detail list of circumstances that could lead to considering that the condition for entry into resolution are met[6]. Similarly, in the EU regime, the ESMA guidelines on "failing and likely to fail" set out detailed guidelines that national resolution authorities in the EU should consider in determining whether to trigger resolution. This notably includes a list of objective elements, listed under Guidelines 3 to 7.[7] We would also welcome further description of circumstances that the RBA would consider when deciding not to trigger resolution while the CS facility is going through recovery measures.

We appreciate that the RBA outlines two categories in its resolution planning – default and non-default loss scenarios. We would welcome further detail as to how the RBA would define the point of entry into resolution for each of these scenarios, considering that the waterfall of resources available in recovery for default losses is not available to cover non-default losses[8].

We very much welcome that the RBA acknowledges that "transparency concerning actions in a crisis scenario reduces uncertainty for participants and other stakeholders and promotes confidence and stability". We also welcome the guidance with regards to how the RBA intends to communicate, i.e. that the "RBA would generally expect to publicly communicate" and directly with participants "on an ongoing basis".

Comments on section E: "Conducting resolution: The RBA's resolution powers"

We appreciate that the RBA provides, in this section, a high-level description of the powers it may choose to exercise in resolution, "including by: (a) giving a resolution direction; (b) appointing a statutory manager; (c) exercising its transfer powers".

The explanatory memorandum which accompanied the final legislation also set out that "*For example, the RBA may issue any of the following resolution directions:*

• *to do anything, refrain from doing or do something differently under the CS facility operating rules or procedures (CS facility licensee only);*

• *to amend its operating rules (but in accordance with the procedure to amend the rules outlined in the operating rules) (CS facility licensee only).*

In the description of the direction power, we would welcome further detail as to how the RBA intends to use it, in light of the breadth of the power. We would welcome further detail

[6] See for example Chapter 5 of the HMT CCP Resolution code of practice

[7] See for example Guideline 3 of the ESMA guidelines on "failing or likely to fail"

[8] We appreciate that CPMI-IOSCO are conducting some work on resources for general business risk, and that this work may provide further guidance on the resources available to cover non-default losses in recovery.

as to how the RBA would typically envisage to use this power to direct a CCP to "do or refrain from doing specified actions", in particular, what such actions may be.

We appreciate that in section F, paragraph 62, the RBA provides further clarity around the circumstances in which the RBA would intend to direct a CCP to amend its operating rules. The Associations would caution against any use of the power to amend the CCP's rules in a way that would amount to amending the recovery rules, when resolution has already been triggered, for instance by to adding further loss allocation tools as part or recovery rules, to use in resolution. This power would make resolution less predictable and incentivize clearing participants (clearing members and their clients) to take measures to protect themselves that might not be helpful for overall resolution. The amendment power should also not be used to amend any rights which any clearing participant has to terminate contracts with, or take other action against, a clearing house. We recommend that the guidance includes explicit assurance of this.

Comments on section F: "Conducting resolution: The RBA's expected approach"

We note that in paragraph 61, the RBA notes that it "expects to manage losses and restore critical CS facility services using a CS facility licensee's recovery plan and arrangements, to the extent they have not been exhausted and where their use is consistent with the resolution objective." We acknowledge that other jurisdictions follow a similar approach, with regards to using remaining recovery tools, but also note that one of the reasons for entry into resolution, as set out by the RBA in section D, may be that continuing recovery proceedings may lead to worse outcomes. We also encourage the RBA to consider how it would approach compensation of market participants whose resources have been used in resolution.

In paragraph 62, the guidance includes an example of where the RBA could use its power to direct an amendment to a CS facility licensee's operating rules and procedures, suggesting that it could be used "to remove an impediment in the rules that may prevent the successful implementation of a negotiated outcome mutually agreed between the RBA and participants". It would be helpful if the RBA could provide further detail as to: what is envisaged between such "negotiated outcome mutually agreed" – for example, at what stage of the resolution process it would be negotiated, and how; and also what the impediment in the rules that the RBA would envisage to remove following that procedure could be – i.e. whether the impediment would only be of technical nature, or whether they could also touch on limitation in members' liability.

It would be helpful if the RBA clarified that it does not intend to alter the operating rules to introduce new loss allocation tools or expand the application of existing ones. If clearing participants are unable to estimate potential losses during recovery and resolution, they may take actions to protect their interests that could conflict with resolution objectives, such as closing out their portfolios at the onset of a crisis or withholding market liquidity during recovery.

When discussing loss allocation after the rulebook powers have been used, we very much welcome the clarity provided by the RBA in paragraph 65, which sets out an order in which

resources would be accessed: starting with parental guarantees, to recapitalization, to direction to the parent to support recapitalization, to private sources of funding with external investors.

In paragraph 66, the RBA notes that it "does not expect to use any loss allocation tools that are not included in the CS facility's rules". We understand this to mean that the RBA would still consider allocating losses to market participants by using remaining recovery tools post-entry into resolution. We ask that the RBA consider how it would approach compensation of market participants who have been allocated losses following the CS facility's rules in resolution.

Also in paragraph 66, we welcome the clarity that "the RBA is unlikely to require fundamental changes to loss allocation processes such as the introduction of initial margin haircutting", but we would welcome a much stronger statement ruling it out completely[9]. With regards to loss allocation tools that the RBA may use, further to the application of the CS facility's rules, we would welcome further safeguards, limiting the use of tools such as haircutting variation margin once in a resolution scenario, and restricting the number of cash calls on clearing members that may be used, even when those tools are part of the recovery rules.

As regards recapitalization, we note that future ownership of the CCP should be assessed across all resources provided in resolution, and in light of any compensation in the form of ownership instruments that may be issued to clearing participants.

In this section, we would also welcome further delineation between the RBA's approach in default and/or non-default loss scenarios leading to resolution : in particular, any tools allocating losses to market participants akin to cash calls or variation margin gains haircutting should be explicitly ruled out in non-default loss scenarios even if they were to be part of the CS facility's rules, and accompanied with strict safeguards and compensation in default-loss scenarios.

[9] As for instance in the UK or EU resolution rules.

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 membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry. 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 principal members of derivatives clearinghouses worldwide, FIA's member firms play a critical role in the reduction of systemic risk in global financial markets. You can find more on www.fia.org.

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 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 X, LinkedIn, Facebook and YouTube.