



DCO Resolution

Staff Presentation of the CFTC and FDIC

Market Risk Advisory Committee

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DCO Resolution

- International Agreement Regarding CCP Resolution: Key Attributes & FMI Annex
- International Development of CCP Resolution Strategies
- U.S. Statutory Framework for DCO Resolution
- FDIC-CFTC Coordination Regarding DCO Resolution Planning
- CFTC Regulations to Facilitate DCO Resolution
- DCO Resolution Planning: Unique Issues

International Agreement Regarding CCP Resolution: Key Attributes

- *Key Attributes of Effective Resolution Regimes for Financial Institutions* (“Key Attributes”)
 - October 2011
 - The Key Attributes set out twelve essential features for resolution regimes for all systemically significant or critical financial institutions.

FMI Annex

- *Resolution of Financial Market Infrastructures (FMIs) and FMI Participants (“FMI Annex”)*
 - October 2014
 - Applies to CCPs
 - The FMI Annex contains guidance that supplements the Key Attributes by indicating how particular Key Attributes, or elements of particular Key Attributes, should be interpreted when applying to resolution regimes for FMIs

FMI Annex – Highlights

- Objectives of FMI resolution:
 - Financial stability and continuity of critical FMI functions without exposing taxpayers to loss
 - An effective resolution regime for FMIs should:
 - Achieve continuity and timely completion of critical payment, clearing, settlement and recording functions
 - Facilitate the timely settlement of obligations
 - Maintain continuous access of participants to collateral posted to and held by the FMI that is owed to such participants

FMI Annex – Highlights

- Timing of entry into resolution:
 - Recovery measures are exhausted and have failed to return the FMI to viability and continuing compliance with applicable legal and regulatory requirements, or
 - Recovery measures are not reasonably likely to return the FMI to viability within the timeframe required to enable continued compliance with applicable legal and regulatory requirements

FMI Annex – Highlights

- Powers of resolution authorities:
 - Enforce unexhausted contractual obligations of participants to meet cash calls or make further contributions to a guaranty fund
 - Enforce unexhausted obligations of participants to accept positions of the defaulting participant
 - Write down equity of the FMI
 - Reduce the value of any gains payable by the FMI to participants (*e.g.*, variation margin haircutting)
 - Tear up contracts

FMI Annex – Highlights

- Any power to allocate losses by engaging in variation margin haircutting must respect the rules of the FMI and the hierarchy of claims under the applicable insolvency regime.
- Initial Margin Haircutting: Resolution authorities may write down initial margin of participants only where initial margin is not remote from insolvency, and where consistent with the legal framework and the FMI's rules.
 - In the US, initial margin is remote from insolvency and writing down initial margin is not consistent with the legal framework. Therefore, participants' initial margin for US-based DCOs cannot be written down.

FMI Annex – Highlights

- When considering whether to terminate outstanding CCP contracts, the resolution authority should consider the impact of termination on:
 - Risk management of the CCP's participants, and
 - Financial stability
- The resolution authority should have the power to transfer ownership or critical functions of an FMI to a purchaser or bridge institution.

FMI Annex – Highlights

- Cooperation, coordination, information sharing
 - Crisis Management Groups (CMGs) for FMIs that are systemically important in more than one jurisdiction.
- Recovery and resolution planning:
 - Ongoing recovery and resolution planning.
 - FMI recovery plans should be consistent with PFMI.
 - Resolution authorities should develop resolution strategies and operational plans to facilitate effective resolution of the FMI.

FMI Annex – Highlights

- Resolvability assessments
 - Systemically important FMIs should be subject to regular resolvability assessments.
- Access to information
 - FMIs should maintain systems and controls that can produce and make available information needed for resolution planning and resolution, including information on participants, margin requirements, status of obligations of participants, and links with other FMIs.

International Development of CCP Resolution Strategies

- Cross-Border Crisis Management Group for FMIs (fmiCBCM)
 - Building on KAs and FMI Annex to develop strategies for FMI resolution
 - Started work in late 2015 with an industry workshop
 - CFTC and FDIC participation
 - Continued coordination with CPMI-IOSCO workstream on CCP resilience and recovery
 - Consultations expected in 2016

U.S. Statutory Framework for DCO Resolution

- U.S. Bankruptcy Code
 - Chapter 7 (liquidation)
- Title II (Orderly Liquidation Authority) of the Dodd-Frank Act, which provides the ability to:
 - Create a Bridge Financial Company
 - Transfer assets to a bridge
 - Provide funding from the Orderly Liquidation Fund
 - Enforce contracts, including network rules

U.S. Statutory Framework for DCO Resolution

- DCOs are likely eligible for resolution under the Orderly Liquidation Authority as “financial companies” under FDIC Regulation 12 CFR § 380.3.
- In addition, Section 210(m) of the Dodd-Frank Act (Liquidation of Certain Covered Financial Companies or Bridge Financial Companies) refers to the liquidation of “member property” under subchapter IV of chapter 7 of the Bankruptcy Code, a reference to a provision that is applicable directly and only to DCOs.

FDIC – CFTC Coordination Regarding DCO Resolution Planning

- FDIC and CFTC Staff have engaged in extensive coordination regarding resolution planning for DCOs:
 - Memorandum of Understanding (2015): information sharing in connection with DCO resolution planning.
 - Inter-agency resolution exercises on G-SIB and DCO resolution.
 - Financial Stability Oversight Council (FSOC) working groups on various issues pertaining to DCO resolution.

CFTC Regulations to Facilitate DCO Resolution

- Systemically important DCOs (SIDCOs) must maintain viable plans for recovery or orderly wind-down necessitated by uncovered credit losses, liquidity shortfalls, and other types of risk. 17 CFR § 39.39(b).
- SIDCOs must have procedures for providing the CFTC and FDIC with information needed for resolution planning. 17 CFR § 39.39(c)(2).
- DCOs have been consulting with stakeholders regarding the development of recovery plans and proposed rule changes to implement the plans.

DCO Resolution Planning: Unique Issues

- Distinction between recovery and resolution
- Considerations for timing of entry into resolution
- Incentives created by resolution strategies
- Differences between DCOs and banks
- Continuity of critical functions of a DCO
- Regulatory coordination
- Information sharing