

SOME ISSUES IN CCP RESOLVABILITY

Partial property transfers and central counterparties

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Disclaimer

The views expressed in this presentation are those of the presenter alone and do not reflect those of the Bank of England or the London School of Economics and Political Science.

Three claims about CCP resolution

1. Legal entity structure matters

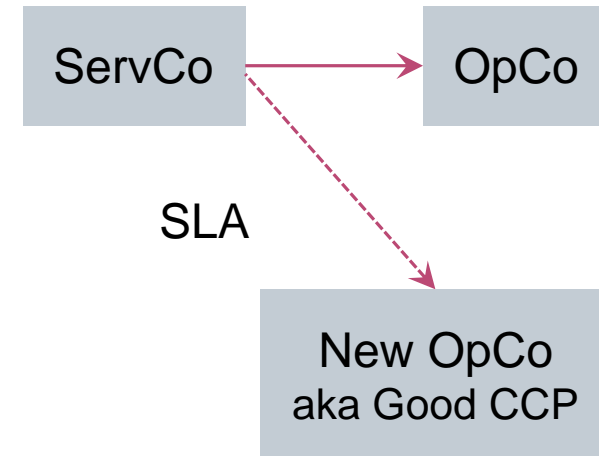
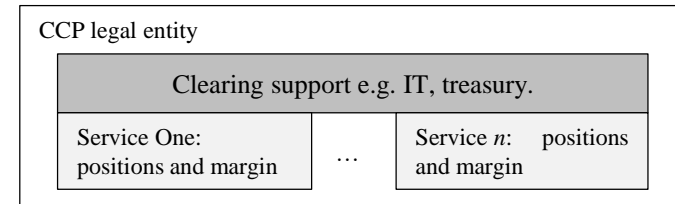
- We are accustomed to thinking of clearing services...
- ...and in ordinary conditions margining, segregation, netting etc. happens at the service level
- Sometimes resolution of a *service* might make most sense
- But there are sometimes multiple services in a legal entity, and this complicates resolution. Resolution works on *legal entities*, not services.

2. Resolvability would be enhanced if CCP legal entity structure supported service level resolution

3. The credit safeguard in resolution, ‘no creditor worse off’, should support this strategy

CCP legal entity structure matters: detail

- Some systemic CCPs have multiple clearing services in the same legal entity
- It is possible to imagine wanting to resolve **a single clearing service**
- But netting in bankruptcy in English law is likely at the whole legal entity level
- So we potentially have to consider claims on the legal entity in bankruptcy, not claims on the service
- Clearing requires support: IT, treasury etc.
- **A ServCo/OpCo structure** with each clearing service in a single legal entity would eliminate this issue



Before resolution

- ServCo runs clearing under SLA with OpCo
- OpCo owns initial margin and default fund
- OpCo is the counterparty to trades
- OpCo is owned by its equity holders

After resolution

- ServCo runs clearing under SLA with New OpCo
- ServCo supports (Old) OpCo's claim against the defaulter
- New OpCo owns Non-defaulters' margin. Defaulter's margin, SITG, DF used to absorb losses
- New OpCo is the counterparty to trades
- New OpCo is owned by clearing members (who met RA call)?
- Old OpCo still has the same owners, but their only asset is a claim on the defaulter

Bank vs Systemic CCP resolution tools

Tool	Bank rationale	Systemic CCP Potential Issues
Private sector purchase	Transfer to a private sector purchaser	Limited no. of buyers
Bridge	Buy time to wind down/sell	Clearing infrastructure would be needed
Bail-in liabilities	Absorb losses, recapitalise	There aren't meaningful bail-in'able liabilities
Asset separation/PPT	Strip the saleable (good) from the bad	Creditor safeguard, as we discuss next
Bank administration	Put the bad bank into administration	Continuity of provision of clearing
Re-cap in place	Bail-in does this	May be needed for some current CCPs

Assumptions & context

- The point of non viability can be identified
- (For CCPs, it may be hard especially if the book has not been balanced)
- There is time to conduct resolution processes
- There are liabilities which can be bailed-in or called upon i.e. extra resources are available in resolution
- CCPs are part of a bigger group; the parent may want to re-cap

Partial property transfer resolution is sometimes attractive

The no creditor worse off safeguard

- The bank no creditor worse off (NCWO) safeguard entitles creditors to compensation from the state if it is determined that the amount they end up recovering in a partial property transfer resolution is less than what it is estimated they would have recovered if the bank had been placed into insolvency
- We are concerned with the resolution of systemic CCPs
- These CCPs have substantial recovery tools which are intended to comprehensively allocate losses
 - Notably in many cases tear-up in the default waterfall
- Do we assume full application of these before bankruptcy?
 - They don't hit CCP equity, so we can't write that down in a PPTR
 - The price of tear up matters a lot for loss allocation: see the New Zealand Futures and Options Exchange example

A suitable safeguard

Consider the partial property transfer resolutions you might want to conduct. **It is advantageous if the safeguard mirrors the resolution action.**

This suggests a potential **service level definition of NCWO**

- Assume full use of all the CCP's skin in the game, funded default fund and defund fund calls available to the CCP up to (but not including) any Resolution Authority call
- Then a partial tear-up of those opposite the defaulter at a price which fully uses those resources at the point of transfer

Finally, do you need an equity write down tool in the waterfall? Is there a compelling reason in resolution for write down other than fairness?