

# Regulatory Alert

Financial Services Regulatory Insight Center



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## FSB consults on financial resources to support CCP resolution

### Key points

- The FSB's 2018 Resolution Report highlights that, across jurisdictions, resolution reforms are most advanced in the banking sectors and that more work is needed with regard to insurance companies and central counterparties (CCPs).
- The FSB has issued a discussion paper seeking input on considerations for the resolution of CCPs in anticipation of more formal guidance to be proposed in 2020.
- The U.S. Treasury has recommended the U.S. regulators improve oversight of CCPs and finalize an "appropriate" regulatory framework for their recovery or resolution.

The Financial Stability Board (FSB) published the 2018 edition of its annual Resolution Report on November 15 ahead of the G20 Leaders' Summit. The report finds that jurisdictions have undertaken substantial reforms to implement a framework and policies for resolving systemically important financial institutions (SIFIs); progress is most advanced in the banking sector but less advanced for insurance companies and central counterparties.

The FSB suggests that "CCPs' criticality to the overall safety and soundness of the financial system means that authorities must take steps to ensure that CCPs do not themselves become a source of systemic risk and that any CCP can be successfully resolved without resort to a government 'bailout'." The FSB further concludes that additional guidance is needed to assist with resolution planning for CCPs and, accordingly, has released a discussion paper that outlines considerations for evaluating whether existing financial resources and tools are adequate to achieve the resolution of an individual CCP. Comments on the paper will be welcomed through February 1, 2019; responses will

inform proposed guidance that the FSB expects to release by the end of 2020.

### Assessing the adequacy of a CCP's financial resources to support resolution:

The design of an individual CCP's resolution strategy and resolution plan are influenced by the products it clears as well as its unique features. The FSB's discussion paper outlines a five-step process that authorities may use to evaluate a CCP's resolution strategy, including stress testing of the adequacy of its financial resources to cover the CCP's losses, consistent with the FSB's July 2017 [Guidance on Central Counterparty Resolution and Resolution Planning](#). The sequential steps include:

1. **Identify hypothetical default and non-default loss resolution scenarios:** Scenario analysis should assume that resolution would occur if a CCP is systemically important, that recovery of critical functions or an orderly wind-down cannot be achieved, and/or that recovery or a wind-down would likely compromise financial stability. Non-default risks that could lead to loss include:

investment risk, operational risk, legal risk, and nonperformance of vendors or service providers.

2. **Evaluate existing tools and resources for resolution:** Both qualitative and quantitative assessments of existing resources and available tools should be evaluated in light of the resolution scenarios. The evaluation could include consideration of design issues, execution risks, financial stability implications, "no creditor worse off than in liquidation" implications, the potential impact on stakeholder incentives to support recovery or resolution, and the feasibility and credibility of maintaining continuity of critical functions for default and non-default loss scenarios.
3. **Analyze resolution costs:** Authorities should assess the different types of costs that could arise in default and non-default scenarios, including the CCP's losses, the costs of replenishing its financial resources, and the resolution authority's operational costs. Additional costs may include support for the operational continuity of the CCP's critical functions while authorities implement the resolution strategy and the CCP can exit from resolution.
4. **Compare tools and resources to resolution costs and identify gaps:** The resolution cost should be compared to existing tools and resources and potential shortfalls or gaps identified, such as whether the tools and resources are sufficient to cover the costs over the resolution timeframe, or whether there is a requirement for additional evidence or analysis to determine additional financial resource needs.
5. **Consider availability, costs, and benefits of different means of addressing gaps:** Finally, authorities may need to consider other issues, including: (a) options for addressing gaps; (b) whether the composition or size of existing tools or resources may need to change; (c) whether additional tools or resources are needed to support resolution; (d) the costs and benefits of each option

and their implications for incentives during business as usual, default management, recovery, and resolution; and (e) any unintended consequences of each option.

**Treatment of CCP equity in resolution:** The discussion paper also addresses considerations to guide authorities in developing possible approaches to the treatment of CCP equity in resolution. The FSB states that, when developing resolution plans, relevant authorities need to have a clear understanding of the treatment of equity under existing recovery arrangements distinguishing between default and non-default loss scenarios. In particular, the FSB suggests authorities might consider:

- Mechanisms for adjusting the treatment of CCP equity in resolution
- The point in time for imposing losses on equity
- Potential challenges and constraints to CCP equity bearing loss in resolution
- Policy considerations for the treatment of equity in resolution.

**U.S. Treasury Report:** A key point highlighted by the U.S. Department of the Treasury in its [report](#) on capital markets was a recommendation to improve oversight of financial market utilities (FMUs), including CCPs. Treasury noted that the U.S. regulators must finalize an "appropriate" regulatory framework for FMU recovery or resolution to avoid taxpayer-funded bailouts. Treasury stresses that the primary focus of recovery and resolution efforts for CCPs must be on recovery such that the CCP can continue to provide critical services to financial markets. Treasury encourages the CFTC and FDIC to coordinate on the development of viable recovery wind-down plans for CCPs that are systemically important financial market utilities (SIFMUs). The Treasury report also notes that U.S. regulators should coordinate with their international counterparts to focus planning efforts on non-default scenarios as well as consider coordination challenges during cross-border resolutions.

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