



HM Treasury

Expanded Resolution Regime: Central Counterparties

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Chapter 1

Introduction

- 1.1 This consultation paper sets out the Government's proposals to expand the resolution regime for Central Counterparties (CCPs).
- 1.2 CCPs are a type of Financial Market Infrastructure (FMI) that provide more certainty that specific types of financial contracts, including derivatives, will, if cleared through the CCP's services, be honoured if one of the counterparties to a trade were to default. This helps to ensure that financial markets are both safer and more efficient. In the UK, CCPs are supervised by the Bank of England ("the Bank") which is also the UK's resolution authority (RA).
- 1.3 The financial crisis in 2007-08 highlighted how essential CCPs are for safeguarding financial stability. When Lehman Brothers defaulted in 2008, counterparties did not suffer substantial losses with regard to their cleared trades, and in most cases suffered no loss at all. LCH Limited (the UK's largest CCP) used around one third of the \$2 billion of collateral it had called from Lehman Brothers to ensure the trades cleared through the CCP were settled successfully.
- 1.4 Following this, at the G20 Pittsburgh summit in 2009, G20 leaders agreed that most standardised and liquid derivatives contracts should be processed through a CCP (otherwise known as "clearing"). The increasing use of CCPs due to the introduction of the resulting clearing obligations has furthered their importance in the financial system.
- 1.5 Given the significance of CCPs to the resilience of the financial system, it is important that there is a robust regime for their recovery (the process by which a CCP manages the default of one or more of its members or losses arising for other reasons) and resolution (the process by which the Bank can intervene if recovery fails). The Financial Stability Board (FSB) has consulted and issued guidance on how best to implement an effective CCP Recovery and Resolution (R&R) regime (see Chapter 2).
- 1.6 As the UK was one of the first jurisdictions to legislate to establish a CCP R&R regime, the current regime pre-dates the recently agreed FSB guidance.¹ The EU has now implemented its own CCP R&R regime. The UK was a key influencer in the development of the EU file and was supportive of the way the final version implemented FSB standards. The UK also has an ongoing commitment to implementing global standards. Therefore, HM Treasury

¹ The Financial Services Act 2012 extended the special resolution regime contained in the Banking Act 2009 to apply to CCPs. This sets out the stabilisation options and powers available to the Bank of England for CCPs, and the conditions for their use.

(HMT), along with the Bank, is working with stakeholders to consider further development of the UK regime to bring it in line with international standards. As a result, apart from few technical areas, the EU regime is not significantly different from the proposed UK regime.

- 1.7 The Government's overall approach when designing the regime is to support the Government's priority to preserve the stability of the UK's financial system and the economy, and ensure the UK remains a world leader for the regulation of clearing services. Consistent with the legal objectives in the Banking Act 2009 and Financial Services Act 2012, this approach is guided by several intertwining principles:
- a. Ensuring the continuity of clearing services
 - b. Protecting and enhancing the stability of the financial system of the UK.
 - c. Protecting and enhancing public confidence in the stability of the financial system of the UK.
 - d. Protecting public funds.
 - e. Avoiding interference with property rights.
 - f. Ensuring consistency with international standards including FSB guidance.

What are Central Counterparties?

- 1.8 CCPs are financial institutions which firms use to reduce certain risks that arise when trading with others on financial markets.
- 1.9 CCPs sit between the buyers and sellers in bilateral trades, including derivative trades, providing assurance that the obligations under those contracts will be fulfilled. Where a financial contract entered into between a buyer and seller is centrally cleared, the CCP sits between them, becoming the buyer to every seller and the seller to every buyer. Collateral is placed with the CCP in case either party fails to meet its contractual obligations, so that the CCP can use that collateral towards making good on the contract.
- 1.10 CCPs are required to have a rulebook governing their relationship with their clearing members² detailing (among other things) a pre-agreed series of measures to deal with the default of any of its clearing members (also known as the default waterfall). These measures must ensure that the CCP can manage the default of its two largest clearing members and continue to provide clearing services. The default waterfall includes a default fund made up of clearing members' pre-funded contributions that can be used to cover losses that exceed a defaulting member's collateral. These pre-funded financial resources at UK CCPs' clearing services totalled approximately £241 billion as at the end of Q3 2020.

² Firms subject to the clearing obligation are legally required to access clearing services. Firms will do this either by becoming a clearing member of a CCP, or a client of a clearing member. Clearing members are typically large international institutions capable of meeting the CCP's generally stringent membership requirements. A clearing member can then offer clearing services to individual clients.

- 1.11 These processes set out in the rulebook help ensure that, if one CCP member defaults and is unable to fulfil its financial obligations to its counterparties, its own contributions would be used first to cover the losses. If the defaulting clearing member's collateral (its initial margin and contribution to the CCP's default fund) is exhausted, a tranche of the CCP's own capital, known as 'skin in the game' (SITG) would then be used. If the SITG is not sufficient, the loss would be mutualised amongst the other members of the CCP via their prefunded contributions to the CCP's default fund and other measures. This restricts contagion to the wider financial system.
- 1.12 CCPs also simplify the network of exposures by enabling the "multilateral netting" of financial exposures and payments. Multilateral netting is a process that sums up all of a firm's offsetting positions to create one overall position. This has the benefit of reducing the gross exposure a firm has to the market down to a single net exposure to the CCP. This also allows for firms to reduce the amount of capital they are required to hold for the same set of exposures under prudential requirements.
- 1.13 In 2012, new legislation (known as EMIR)³ laid down rules regarding over-the-counter (OTC) derivative contracts, CCPs, and trade repositories, in line with the G20 commitments made in Pittsburgh in September 2009. To note, EU law (including EU Regulations), which had direct effect in the UK until 31 December 2020, has been onshored into UK domestic law. References in this paper to EU law are, as relevant, references to such law as it forms part of EU retained law in the UK. This included introducing obligations to clear in certain circumstances. Since then, the volume of clearing at CCPs, both in the UK and abroad, has increased significantly. For example, for credit default swaps, central clearing increased from 5% at end-June 2010 to 34% at end-June 2017. The increasing use of CCPs has furthered their importance in the financial system.
- 1.14 There are currently three UK CCPs recognised by the Bank:
- a. LCH Limited
 - b. LME Clear Limited
 - c. ICE Clear Europe Limited
- 1.15 Given CCPs' critical position between the buyers and sellers of financial contracts, any disruption at a CCP has the potential to impact other market participants and, therefore, be a source of stress within the wider financial system. Stress within the system could be amplified and spread in several different ways, impacting the ability of market participants to trade.
- 1.16 It is, therefore, important that CCPs are both financially and operationally resilient.
- 1.17 Financial resilience arrangements are designed to enable CCPs to survive financial shocks, particularly those arising from the failure of one or more

³ Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories. It has been 'onshored' (i.e. retained) in UK law under the European Union (Withdrawal) Act 2018

clearing members to fulfil its obligations to the CCP. Losses incurred as a result of the default of a clearing member are referred to as default Losses.

- 1.18 Operational resilience supports CCPs in preventing, responding to and recovering from operational disruptions. Losses incurred as a result of operational disruptions are referred to as non-default losses.
- 1.19 To achieve resilience in both these areas, CCPs need to ensure they have sufficient financial resources, risk management arrangements and contingency plans to withstand financial or operational disruptions, as well as robust governance arrangements to oversee these.
- 1.20 An effective resolution regime is a necessary backstop, ensuring that the RA is able to intervene if the CCP is not able to withstand any financial or operational shocks. By stepping in, the RA can help ensure that critical clearing services are able to continue and thus help prevent any disruption to the wider market.

The current regime

- 1.21 The CCP R&R regime has two main components to help prevent the failure of a CCP. First, CCPs are required to have a recovery plan in their rulebooks to recover from a threat to their viability and financial strength so that they can continue to provide critical services without requiring the use of resolution powers by authorities. Resolution is the second part of the regime and is under the control of the Bank, as the RA for UK CCPs. The resolution regime gives the power (subject to appropriate legal constraints) to the Bank to step in if it determines that recovery will not be successful. This helps ensure that a CCP's critical functions are preserved while maintaining financial stability and also helps to avoid the costs associated with the failure and potential restructuring of the failing CCP from falling on taxpayers.
- 1.22 The risk of a CCP requiring resolution action is low. As above, CCPs should be able to manage the default of at least their largest two clearing members through the measures set out in their default waterfall. Managing the default of a clearing member is what a CCP is designed to do.
- 1.23 Amendments to the Banking Act 2009 extended the UK's resolution regime for banks to include CCPs (although the regime takes a different approach to a CCP resolution in comparison to a bank resolution, reflecting a CCP's specific characteristics). Two conditions have to be met for resolution to be triggered. First, the Bank must be satisfied that a CCP is failing or likely to fail. Second, the Bank must be satisfied that it is not reasonably likely that action will be taken by or in respect of the CCP that will enable the CCP to maintain the continuity of its critical clearing services. Any decision to put a CCP into resolution is also conditional on this being in the public interest.⁴ Under the current regime, the Bank is required to consult HMT and the FCA when making its assessment that action is not likely to take place that would enable the continuity of the CCPs' critical clearing services. The Bank is also required to consult HMT before determining that the exercise of a stabilisation power is in the public interest. HMT consent is required if the

⁴ The 'public interest' refers specifically to the public's interest in the financial stability of the UK, and the maintenance of public confidence in the stability of those systems.

exercise of a power would likely have an impact on public funds. Where HMT have already provided financial assistance, the Bank may only exercise a stabilisation power if HMT have recommended it as necessary to protect the public interest and the Bank agrees this is appropriate. This is important to ensure that public law restrictions and the potential impact on public funds are considered, as well the potential impact on a CCP's clearing members and clients.

- 1.24 Under the current regime, the Bank has the power to: (a) transfer to a private sector purchaser all or part of the CCP's business; (b) transfer to a bridge institution all or part of the CCP's business; or (c) transfer the ownership of the CCP to any person.
- 1.25 The CCP's rulebook contains many of the additional tools the Bank would require to resolve a CCP. However, the Bank would currently be limited in how it could use these by the parameters of the rulebook, which differ across CCPs and across CCP services.

The proposed regime

- 1.26 An expanded CCP resolution regime would give the Bank additional powers to mitigate the risk and impact of a CCP failure and the subsequent risks to financial stability and public funds. These new powers would help to better protect financial stability by enabling the Bank to take full control of a CCP when necessary and use a number of tools without reliance on the CCP's rulebook. This would mean the Bank could take faster and more extensive action to stabilise the CCP than it can now. These powers would also limit risks to public funds by ensuring CCPs and clearing members ultimately bear the losses arising from a CCP failure, rather than taxpayers, whilst still stabilising the CCP, preventing contagion and providing reassurance to the market.
- 1.27 The new regime would add to the existing CCP resolution powers, which will be retained. The Government will consider how best to legislate for the proposals set out in this consultation. We will legislate when parliamentary time allows.
- 1.28 Consistent with FSB guidance, the tools would also be designed to balance the incentives of clearing members and CCP shareholders to encourage appropriate risk management and behaviour ahead of, and during, a resolution. The tools would include, for example, a requirement for cash contributions from clearing members in resolution, a tool to write down unsecured liabilities, and a requirement for there to be an additional tranche of a CCP's own capital to absorb losses.
- 1.29 To provide additional protection, a provision would also be included to compensate CCP shareholders, creditors and clearing members if they are left worse off in a resolution than if the CCP were to fail (the "No Creditor Worse Off", or "NCWO", safeguard). This provides additional incentives for clearing members to continue to centrally clear, as well as incentivising the Bank to ensure it carries out its resolution actions responsibly.

Chapter 2

The Proposed Expanded Resolution Regime

2.1 When used together, the proposed powers and tools form a robust regime which would give the Bank the flexibility to effectively (i) stabilise a CCP, so that it can continue to provide its critical clearing services, (ii) prevent contagion spreading across the financial system; and (iii) ensure losses are allocated fairly across CCPs and clearing members, rather than to taxpayers. For clarity, we have separated the proposal into three categories: general powers, loss-allocation powers and safeguards, and other powers. While Chapter 2 provides an executive summary, further detail on our proposed regime is set out in Annex A. This includes specific questions which are reproduced in Chapter 3.

General powers

Removal of material impediments to resolvability

2.2 This power would enable the Bank to require a CCP to make ex ante changes to its arrangements to remove potential barriers to resolvability identified by the Bank. Whilst the Bank expects it will encourage CCPs to make changes through less formal discussions, this power would be a valuable backstop.

Conditions and timing for entry into resolution and engagement between authorities

2.3 Some measures within a CCP's recovery plan could have an impact on wider markets. This power would enable the Bank to place a CCP into resolution (by exercising a resolution power) before the CCP's own recovery measures have been exhausted, on the condition that continued recovery actions by the CCP would likely 'compromise financial stability'. The existing requirement for the Bank to consult HMT prior to determining that condition 2 for resolution (See Annex A for further detail) is met would be extended to this new resolution condition.

Lockdown or deferral period on the payment of dividends, buybacks or variable remuneration

2.4 This power would enable the Bank to temporarily restrict or prohibit any remuneration of equity in severe circumstances, including if there is a rapid deterioration in the financial situation of the CCP, and it was therefore at risk of failing. It would be available as an early intervention measure, but also after the CCP has entered resolution, in order to ensure that resources can be directed to compensation payments and replenishing public funds where these have been used as a last resort, should either be necessary.

Power to suspend termination rights

- 2.5 This power would give the Bank the ability to stay temporarily any right to early termination of participation by a clearing member that arises as a result of a CCP being placed in resolution. This would help stabilise the clearing services offered by the CCP and ensure the Bank has access to the largest possible pool of resources for loss absorbency, thereby limiting risks to public funds.

Power to take control of the CCP

- 2.6 This power would enable the Bank to take control of a CCP without having to rely on its existing property or share transfer powers. This would allow the Bank to more easily enforce the CCP's rulebook to stabilise the CCP and ensure continuity of the critical clearing service(s) in resolution, without the legal and operational risk of conducting a property or ownership transfer.

Power to remove and replace directors and senior executives and to appoint temporary managers

- 2.7 This proposal would provide the Bank with the power to direct a CCP to remove or replace directors and senior executives and appoint temporary managers in severe circumstances, as the PRA and FCA are already able to do for other types of financial services firms. It would only be used if there was a rapid deterioration in the financial situation of the CCP and it was therefore at risk of failing, or if there was an infringement by the CCP of a relevant requirement, including its operating rules.

Power to return the CCP to a matched book

- 2.8 Providing the Bank with the power to return a failing CCP to a 'matched book' would ensure that the CCP does not continue to be exposed to losses generated by the positions of the defaulting clearing member(s). The Bank would have the flexibility to perform a full or partial tear up of contracts, depending on the scenario and the potential wider impacts on financial stability. In order to provide clearing members and end users with greater certainty of how these powers would work in practice, the Bank will set out how it intends to use these powers in the event of a CCP failure.

Loss-allocation powers and safeguard

No creditor worse off (NCWO) safeguard

- 2.9 This safeguard would replicate an existing safeguard in the bank resolution regime. It will ensure that creditors of the CCP (such as clearing members and, where they are direct creditors of the CCP, clients), would have a right to compensation should they be left worse off in resolution than they would have been in the absence of resolution action. Under this proposal, only the direct costs that creditors would have experienced in the absence of resolution action being taken would be included in the valuation of the NCWO counterfactual (i.e. only the losses they would have been allocated in line with the CCP's rulebook).

Deviation from a CCP's rules and arrangements

- 2.10 The proposal would allow the Bank to deviate from a CCP's rules and arrangements. In some circumstances, it could be appropriate for the Bank to deviate from a CCP's rulebook if relying on the processes under the CCP's rules would risk significant adverse impacts on financial markets.

Second tranche of skin in the game

- 2.11 CCPs are already required to hold a ring-fenced tranche of their own capital ("skin in the game" or "SITG") as part of their recovery measures. This proposal introduces a second tranche of CCP SITG sitting after the prefunded default fund, requiring CCPs to hold a greater amount of capital for loss absorption. This will reinforce the incentives for CCPs to conduct robust risk management and ensure that their default fund is appropriately sized. This second tranche will be calibrated based on the CCP's risk-based capital requirements, to ensure its size is proportionate to the individual CCP and the risk it is clearing. The Bank will be empowered to specify the exact methodology for calculating the amount of SITG CCPs will be required to hold.

Power to perform variation margin gains haircutting (VMGH)

- 2.12 In resolution, this would give the Bank the ability to reduce or cancel the variation margin payments that a CCP would otherwise have been required to make to clearing members whose house and client positions have gained value. The tool would allow the Bank to haircut beyond the quantum or length of time provided for in the CCP's rulebook in order to provide additional loss absorbing capacity in resolution. Without this tool, resources in excess of the limit on VMGH contained in the CCP's rulebook would only be accessible following the closure of the critical clearing service (as would occur in recovery). This tool would only be available for use in a default loss scenario.

Powers to generate additional loss absorbing capacity through write down of unsecured liabilities (in non-default scenarios) and collecting cash contributions from clearing members (cash call power, in both default loss and non-default loss scenarios)

- 2.13 These powers work to provide loss absorbency in both default loss and non-default loss scenarios. Having both tools allows the Bank flexibility to allocate losses in resolution through the mechanism that it judges to be least disruptive, considering the circumstances at the time. Safeguards will be attached to these powers. The Bank would be prevented from writing down certain liabilities when using its write down power, including initial margin. The quantum of resources that could be called upon using the cash call power would also be capped at two times an individual clearing member's prefunded contribution to the default fund in a default loss scenario, and at three times in a non-default loss scenario. This should allow clearing members to always understand the maximum amount they may be required to contribute.

Other powers

Power to delay enforcement of a clearing member's obligation in resolution

- 2.14 This power enables the Bank to delay enforcement of a clearing member's obligations in resolution should such enforcement during the resolution of the CCP present a risk to financial stability. The Bank would have a power to enforce outstanding obligations resulting from such a delay in enforcement at any time up to 18 months after the resolution, if at the relevant time the reasons for refraining from their enforcement no longer exist. If the Bank does not enforce an outstanding obligation within this 18-month period, the obligation will lapse at the end of it.

Replenishment

- 2.15 This power would enable the Bank to use statutory loss allocation tools (VMGH, cash calls and write down powers) to recapitalise the CCP and replenish its prefunded resources, not just absorb losses. This tool could also be used to repay public funds, in the event of a scenario where they have been called upon as a last resort.

Compensation

- 2.16 If a clearing member is compensated, either as a result of the NCWO safeguard or otherwise, compensation could take the form of: proceeds from the delayed enforcement of a clearing member's obligations; claims on a share of the CCP's future profits; profits resulting from the sale of the CCP; equity in the CCP; or potentially, as a last resort, public funds. The use of public funds for compensation would be the very last resort and would be subject to explicit consent from HMT. If a clearing member is compensated, they should not be mandated to compensate their clients. This protects the relationship between clearing members and clients, which should be a private contractual agreement which will govern any rights and obligations regarding the pass through of compensation from the clearing member to its underlying client. Clients will only be entitled to a direct claim where they are a direct creditor of the CCP.

Chapter 3

Responding to this Consultation

Responding to this consultation

- 3.1 This consultation will close on the 28th of May 2021. We would welcome your views on the proposals set out above and detailed in Annex A, or on any issue relevant to the UK's approach to CCP resolution.

How to submit responses

- 3.2 Please submit your responses to ccp.resolution.consultation@hmtreasury.gov.uk or post to:
HM Treasury – Financial Market Infrastructure
1 Horse Guards Road
SW1A 2HQ
- 3.3 More information on how HM Treasury will use your personal data for the purposes of this consultation is available in Annex B.

Box 3.A: Consultation Questions

- I) Do you agree with the proposed scope of our NCWO safeguard and counterfactual?
- II) What factors should be taken into account when calculating the quantum and position in the default waterfall of the second tranche of SITG?
- III) Do you agree with the proposal to limit the statutory VMGH power to default loss scenarios, and instead have a larger cap on the cash call for non-default-loss scenarios?
- IV) Do you agree with the proposed power to delay the use of resolution tools for up to 18 months and its current scope?
- V) Do you agree with the modalities of the proposed compensation process?
- VI) What lead in time would be appropriate for industry to prepare for the new regime? Are there any elements of the new regime that would not require a lead in time?
- VII) Do you have any other thoughts on the proposals that you would like to bring to our attention

Annex A

The Proposed Resolution Regime

- A.1 The proposed UK CCP resolution regime seeks to implement international standards developed by the FSB, which has set out a framework for CCP resolution, including the recent November 2020 'Guidance on Financial Resources to Support CCP Resolution and on the Treatment of CCP Equity in Resolution', and to reflect CPMI-IOSCO standards on CCP resilience and recovery. The UK continues to participate in discussions with the FSB on CCP resolution issues. The UK has an ongoing commitment to implementing global standards in financial services, and as such the UK authorities will consider further measures as and when these standards evolve. These proposals relate to standards as they are now.
- A.2 The proposed UK regime would create a set of powers to address the deficiencies identified by FSB guidance. To make it easier to review the proposals, we have separated the powers into three categories: general powers, loss-allocation powers and safeguard, and other powers.

General powers

Removal of material impediments to resolvability

- A.3 FSB guidance requires that supervisory authorities or RAs should have the power to require a CCP to remove material impediments to resolvability. Such impediments might be in relation to the CCP's existing rules and arrangements, or their operational, structural and legal frameworks, which could be considered a potential threat to the successful execution of a CCP's resolution.
- A.4 The current UK CCP resolution regime does not include this power and the Bank may therefore be unable to require a CCP to remove a material impediment. Although it is likely that CCPs would agree to make most necessary changes if the Bank were to request them to, a legal power requiring CCPs to remove impediments to resolvability would be a valuable backstop.
- A.5 Therefore, under the proposed regime, the Bank would have a statutory power to require a CCP to remove material impediments to resolvability.

Conditions and timing for entry into resolution and engagement between authorities

- A.6 FSB guidance requires that RAs have the power to place a CCP into resolution prior to the end of a CCP's existing recovery arrangements where the CCP is, or is likely to be, no longer viable or no longer able to meet

regulatory requirements on a continuing basis. This includes cases where it is likely that the CCP's implementation of the recovery measures will not be sufficient to return the CCP to viability in a timely manner; or the CCP will be unable to apply recovery measures in a manner that does not give rise to significant risks to financial stability."

- A.7 Under the current regime, a stabilisation power may be exercised with respect to a CCP only if the Bank is satisfied that the following general conditions have been met. The first condition is that the CCP is failing, or is likely to fail, to satisfy the recognition requirements. The second condition is having regard to timing and other relevant circumstances it is not reasonably likely that (ignoring the stabilisation powers) action will be taken by or in respect of the CCP that will enable the CCP to maintain continuity of any critical clearing services it provides while also satisfying the recognition requirements. CCP services are deemed 'critical' if the removal of such services, in the Bank's opinion, would threaten the stability of the financial systems of the UK. The Bank may treat condition 1 as met if satisfied that it would be met but for the withdrawal or possible withdrawal of critical clearing services by the CCP.
- A.8 Under the current regime, the Bank is not able to place a CCP into resolution before the CCP has completed its recovery actions even in circumstances where allowing the CCP to continue would threaten UK financial stability.
- A.9 The proposed CCP R&R regime would introduce an additional trigger for entry into resolution to operate alongside the two-existing conditions set out in the paragraph above. This new condition would allow the Bank to use its CCP resolution powers before the CCP has completed its recovery measures, if the Bank considers that the continued application of these measures would have an adverse impact on financial stability.
- A.10 Under the current regime, the Bank is required to consult HMT and the Financial Conduct Authority (FCA) before determining whether the second condition is met (that action is not likely to take place that would enable the CCP to continue to provide its critical clearing functions).
- A.11 The proposal extends this consultation requirement to the new proposed condition for entry into resolution. The Bank should continue to be required to notify and consult HMT and the FCA ahead of any action where resolution action would pose risks to financial stability. However, given the potential fast-burn nature of a CCP resolution scenario which may make this consultation challenging, it is proposed that the Bank would be required to share resolution plans for CCPs with HMT in advance, with the ability for the Bank to diverge from these plans without prior consultation in certain circumstances. Any divergence would need to be notified to HMT ex-post.
- A.12 This would allow the Bank to take swift and decisive action to reduce risks to financial stability, whilst keeping appropriate safeguards in place for HMT to approve decision-making that may affect public funds. It is worth noting, as explored in more depth later in this paper, that the key purpose of expanding the resolution regime is to reduce the likelihood that public funds would be needed in a CCP resolution, and we therefore judge that the

overall likelihood of public funds needing to be used under the new regime is low.

Lockdown or deferral period on the payment of dividends, buybacks or variable remuneration

- A.13 In June 2020, as a result of additional risks and potential financial and operational demands arising from Covid-19, the Bank wrote to all UK regulated FMIs (including CCPs) to set the expectation that FMIs should discuss with the Bank in advance of making any distributions to shareholders, or making decisions on variable remuneration. This was consistent with the statement made by the PRA in March 2020, which set the same expectations for banks.
- A.14 Whilst these expectations were fulfilled by both banks and FMIs, the Bank does not currently have a legal means to enforce such a decision and is, therefore, reliant on moral suasion.
- A.15 This proposal would introduce the power for the Bank to temporarily restrict, freeze or prohibit any remuneration of equity or instruments treated as equity (including dividend payments and buybacks by the CCP) and restrict, freeze or prohibit any payments of variable remuneration, in severe circumstances, including if there is a rapid deterioration in the financial situation of the CCP and it was therefore at risk of failing.
- A.16 It should be available as an early intervention measure, but also after a CCP has entered resolution in order to ensure that resources can be directed to compensation payments and replenishing public funds, should either be necessary.

Power to suspend termination rights

- A.17 FSB guidance requires that the RA should have the power 'to stay temporarily such rights where they arise by reason only of entry into resolution or in connection with the use of resolution powers'. This should help stabilise the clearing services offered by the CCP, and ensure the RA has access to the largest possible pool of resources for loss absorbency at the point of resolution, thereby minimising any potential future impact on public funds.
- A.18 As is required by FSB guidance, this proposal will give the Bank the power to impose restrictions on clearing members' rights to early termination of participation that may arise as a result of a CCP being placed into resolution or the exercise of associated resolution powers.
- A.19 A statutory power would ensure that it is enforceable in the compressed timeframe which is likely to characterise a resolution. This is a requirement in the FSB guidance.
- A.20 The stay would be a mandatory contractual provision between CCPs and clearing members, as this strengthens the ability to enforce the requirement on a cross-border basis. This may require CCPs to update their rulebooks.
- A.21 Termination rights would only be suspended until the end of the working day which follows in order to avoid increasing uncertainty and instability in

the market. For the avoidance of doubt, during the operation of the stay, clearing members would still be able to 'trade out' of their positions at the CCP through normal trading activity, subject to sufficient market liquidity being available.

Power to take control of a CCP

- A.22 In addition to the Bank's existing stabilisation powers, the proposal introduces the power for the Bank to take control of a CCP. This is because, in a fast-burn scenario, it is important that the RA is able to take swift and decisive action.
- A.23 This would allow the Bank to exercise all the rights, obligations, and powers conferred upon shareholders and the CCP's board, including the rights and powers under the operating rules of the CCP.
- A.24 Allowing the Bank to take control of the CCP is also a means for the Bank to enforce the CCP's rulebook without having to place the business of the CCP into a bridge entity or transfer the ownership of the CCP.

Power to remove and replace directors and senior executives and to appoint temporary managers

- A.25 The Financial Services and Markets Act 2000 (FSMA) currently allows the PRA and FCA to direct certain firms to remove or replace directors and senior executives in severe circumstances, including a significant deterioration in the financial situation of the relevant firm or a serious infringement by the firm. FSMA also provides the PRA and FCA with the power to appoint a temporary manager to a firm. FSMA sets out the conditions and procedures for the use of these powers. To note, provisions in onshored EMIR also give a similar power to the CCP's supervisor, but this power is limited to where "the conduct of a member of the board is likely to be prejudicial to the sound and prudent management of the CCP".
- A.26 This proposal extends these existing powers in FSMA (including the conditions and procedure for their use) to cover CCPs.

Power to restore a matched book

- A.27 FSB guidance requires the RA to have at least one of a number of possible prescribed powers to rematch a CCP's book. A CCP's book would become unmatched if a clearing member defaults, leaving the CCP exposed to losses materialising from the positions that the clearing member had held. According to its default management procedures, a CCP would usually conduct an auction to sell off these positions. If successful, these positions would be taken on by another clearing member (re-matching the book) and any loss generated to the CCP from the defaulting clearing member's positions losing money would crystallise. A CCP would then use the default waterfall process to allocate this loss.
- A.28 The ability to re-match the CCP's book is an essential component of the Bank's ability to manage a default loss scenario where the CCP is unable to independently re-match its book at a price which does not use up an unacceptable level of the loss absorbency available under its rulebook. The

preferred FSB position management tool to achieve this is a partial tear up power. A partial tear up power would allow an RA to tear up a sub-set of contracts held in the relevant clearing service at a CCP.

- A.29 “Tearing up” contracts does not mean that the value of the contract is considered to be zero. Therefore, the partial tear up power would not be used as a means of loss allocation. Rather, the contract would be cash settled at a commercially reasonable price at the moment of tear-up in resolution. This price would reflect the “value” of the contract which would incorporate the market price (reflecting the market instability), defined here as a commercially reasonable price, and would be determined by the CCP. This would also minimise the risk that the partial tear-up would be inconsistent with netting and accounting standards for cleared positions.
- A.30 Once the CCP’s book has been re-matched, the RA would then use the resources available under the CCP’s rulebook to absorb the resulting loss, potentially in conjunction with other statutory powers to generate loss absorbency.
- A.31 The proposed regime would introduce a partial tear up power to give the Bank the ability to tear up a subset of positions, up to and including a complete tear up of all positions within the affected clearing service, at a commercially reasonable price.
- A.32 FSB guidance states that the ‘resolution authority should establish in advance the general approach it would apply in determining any contract to be torn up’.
- A.33 Under the proposals, the general approach would be established in advance. This will ensure industry understands how any partial tear up will be conducted and how partial tear up would occur in a fair, transparent and non-discriminatory manner.

Loss-allocation powers and safeguard

No Creditor Worse Off (NCWO) Safeguard

- A.34 FSB guidance states that clearing members, equity holders and creditors should have a right to compensation where they do not receive in resolution at a minimum what they would have received if, instead of resolution, the CCP had been liquidated under the applicable insolvency law. This is known as the “No Creditor Worse Off” (NCWO) safeguard. The assessment of the losses that would have been incurred if the CCP had been subject to liquidation should assume the full application of the CCP’s rules and arrangements for loss allocation. The UK regime would follow the same approach.
- A.35 The NCWO safeguard already exists in the UK’s banking resolution regime. It ensures that the affected shareholders and creditors will not be worse off than in a case of the bank having entered into normal insolvency proceedings.
- A.36 The current UK CCP resolution regime does not contain an explicit NCWO safeguard.

- A.37 The proposal introduces an explicit NCWO safeguard in the CCP resolution regime. This will ensure that, like the safeguard for banks, where one or more statutory resolution powers have been used, if any shareholder, clearing member or other creditor is left worse off in resolution than they would have been under the NCWO counterfactual, they would be entitled to compensation.
- A.38 By setting out a clear and transparent counterfactual, consistent with FSB guidance, this NCWO safeguard proposal will increase market certainty, reduce any risk of litigation and ensure that clearing members, shareholders and creditors can measure their exposure limit accurately.
- A.39 Under this proposal, only the direct costs which creditors would have experienced under the counterfactual (assuming full implementation of the CCP's rulebook) would be included. We judge that it would be difficult to quantify a commercially reasonable estimate of the indirect costs which creditors would have experienced in the absence of resolution (e.g. costs of reopening comparable net positions in the market, such as those associated with the loss and re-establishment of hedges, and costs connected with the administration of the CCP's estate). That uncertainty would make it more difficult for clearing members and creditors to assess their exposure and provides a higher level of protection to creditors in the event a CCP is placed in resolution.

Box A.1: Do you agree with the proposed scope and counterfactual of the NCWO safeguard?

Deviation from a CCP's rules and arrangements

- A.40 FSB guidance requires that the RA should be able to deviate or refrain from enforcing a CCP's rulebook in resolution, subject to certain safeguards, if this is necessary to achieve its resolution objectives. Given that any potential resolution is an unpredictable scenario, it is important to allow the RA appropriate flexibility to manage the situation most efficiently.
- A.41 It could also be appropriate for an RA to deviate from a CCP's rulebook if the steps and processes under the CCP's rules and arrangements pose significant risks to financial markets.
- A.42 The UK's existing regime does not empower the Bank to deviate, or refrain from enforcing, a CCP's Rulebook. The proposed regime would introduce the power for the Bank to deviate, or refrain from enforcing, a CCP's existing rules and arrangements once in control of a CCP, but subject to the NCWO safeguard.
- A.43 Where action by the RA results in a shareholder, clearing member or creditor incurring greater loss than under the NCWO counterfactual, the NCWO safeguard would apply. The affected creditor would be entitled to compensation.
- A.44 This would appropriately constrain the Bank's choice of actions when considering whether to deviate from the CCP's rules and arrangements. It

should be noted that, whilst allowing the Bank to deviate from the CCP's rules and arrangements has the potential to introduce a NCWO claim, the NCWO safeguard would apply to the overall quantum of losses suffered in excess of the quantum of losses expected under the counterfactual, and is not applied to the use of individual tools. Therefore, the power to deviate from a CCP's rules and arrangements should allow the Bank the flexibility to take the most effective path to resolution, which should ultimately reduce the losses imposed on creditors and, therefore, reduce the likelihood of NCWO claims.

Second tranche of Skin in the Game

- A.45 FSB guidance requires that, for default losses, equity should be fully loss absorbing in resolution. FSB guidance also requires that for non-default losses, equity should absorb these losses no later than at the point at which any applicable loss allocation arrangements available under the CCP's rules and arrangements for non-default losses have been exhausted.
- A.46 The FSB is working hard to agree on an approach to the treatment of CCP equity during a default loss resolution scenario which achieves the objective of full exposure of equity to losses but does not result in shareholders being entitled to compensation under the NCWO safeguard. It issued guidance to RAs on this matter in 2020.
- A.47 Under the UK's existing regime, CCPs' rulebooks have a ring-fenced tranche of the CCP's own capital, referred to as "skin in the game" (SITG). This SITG sits after the defaulter's initial margin and default fund contribution, but before the prefunded default fund, in the default waterfall. It is designed to incentivise robust risk management by the CCP, as these funds are the first to be used should the loss resulting from a clearing member default exceed the defaulting member's initial margin and default fund contributions.
- A.48 This layer of SITG is calculated in accordance with the retained Article 35(2) of Commission Delegated Regulation (EU) No 153/2013, based on a multiple of the individual CCP's minimum capital. Only pre-funded capital can be used as SITG.
- A.49 Under this proposal, CCPs would be required to introduce a second tranche of CCP SITG in their rulebook as part of the default waterfall. This would further expose equity shareholders to losses and would help progress towards the objective of FSB guidance that equity should be fully loss-bearing in resolution. This would also reinforce the incentives for CCPs to conduct robust risk management, and ensure that their default fund is appropriately sized.
- A.50 FSB guidance requires that it should be clear and transparent at which point in resolution any remaining equity would be written down. Under this proposal, this second tranche of SITG would sit after the prefunded default fund, but before cash calls, so that it is used before non-prefunded resources. This is an additional amount of resource which should be clearly distinct from the dedicated resources (first tranche of SITG) referred to in onshored EMIR Article 45(4) (the existing default waterfall).

- A.51 FSB guidance also states: “Existing owners’ equity in the CCP should absorb losses in resolution, to the extent not already written down upon enforcement of the CCP’s rules and contractual arrangements. The power to write down equity of the CCP in resolution should be set out in the legal framework and, where needed, reflected in the CCP’s rules and arrangements, and its constitutive arrangements (e.g. articles of incorporation)”. The intent of FSB guidance, and this proposal on a second tranche of SITG, is to ensure appropriate incentivisation, in addition to increasing the resources available for an orderly resolution, by ensuring that CCP equity is loss absorbing. Introducing a second SITG to the default waterfall has the effect of exposing CCP equity to loss simply by increasing the amount of CCP equity in the default waterfall, in a way that minimises the likelihood of NCWO claims by equity holders on the basis that their losses in resolution are not greater than the losses that they would have incurred otherwise.
- A.52 This second layer of SITG will have to be sized. This should be based on the CCP’s risk-based capital requirements, as set out in onshored EMIR Article 16(2), thereby sizing it proportionately to the individual CCP and the risk it is clearing.
- A.53 As with the current tranche of SITG, the Bank should be empowered to specify the methodology for calculation and maintenance of the amount of the CCP’s own resources that should be included in the second tranche of SITG.

Box A.2: What factors should be taken into account when calculating the quantum and position of the second tranche of SITG?

Variation Margin Gains Haircutting power

- A.54 Variation margin is a form of collateral required to protect parties to a contract, in the event of default by the other counterparty, by limiting the size of the overall exposure that one party can have to another at any one time. For cleared positions subject to cash settled variation margin, variation margin payments are usually made daily or intra-day, in cash, from the party whose position has lost value to the party whose position has gained value, be that the clearing member or the CCP. Variation margin payments provide for changes in the market value of the trade, ensuring that mark-to-market losses from a default are limited to the period since the previous variation margin payment.
- A.55 Variation margin gains haircutting (VMGH) is a loss allocation tool whereby a CCP can absorb losses by reducing or cancelling the variation margin payments that it would otherwise have been required to make to clearing members whose house or client positions have gained value. The CCP continues to receive variation margin payments from clearing members whose positions have lost value. The resulting surplus of funds is used to address the outstanding loss.

- A.56 FSB guidance requires the RA to have the statutory power to conduct VMGH in resolution. CCPs widely have VMGH included as a loss allocation mechanism within their rulebooks (for clearing services where variation margin is paid). If the Bank has control of the CCP, it can execute any provisions for VMGH contained in the CCP's rulebook. However, CCP rulebooks generally set limits upon the quantum of VMGH, and the length of time that VMGH can be applied. Under the current regime, the Bank would be restricted by those limits.
- A.57 To help ensure there is adequate loss absorbing capacity in a default loss scenario, the proposed regime would give the Bank a power to conduct VMGH beyond the limits specified in a CCP's rulebook. As with all resolution tools, the use of VMGH by the Bank would be subject to the NCWO safeguard.
- A.58 The proposal would mandate the inclusion of the resolution VMGH power in a CCP's rulebook, although reserved to the RA, to provide a contractual hook for the enforcement of the Bank's statutory power.
- A.59 This tool would only be available in a default loss scenario. Following a clearing member default, clearing members are already potentially subject to VMGH within the CCP's rulebook. As such, allowing this form of loss absorption in a default loss resolution scenario is appropriate. However, CCP rulebooks do not include VMGH for non-default loss scenarios, therefore permitting VMGH in non-default loss scenarios in resolution would introduce an additional type of uncertainty to a non-default loss resolution event, making it harder for clearing members to predict what their exposures could be. The potential loss absorbency offered by VMGH is dependent on the size of market moves. These may not be as significant in a non-default loss scenario as the market moves might not be as pronounced, making this a less effective tool.
- A.60 The quantum of resources the Bank can haircut under their statutory power should not be capped. Given that CCP rulebooks often have a cap on the use of VMGH, allowing the Bank the flexibility to surpass the limits that a cap would impose should allow for a greater loss absorbency in resolution, subject to the NCWO safeguard.

Statutory cash call power in a default loss scenario

- A.61 As proposed by FSB guidance, a cash call is an alternative tool the RA can use to absorb losses in a default loss scenario via non-prefunded contributions from clearing members. It requires clearing members (i.e. the whole membership) to pay a specified amount in cash to the CCP upon demand, in addition to the prefunded resources in the default fund.
- A.62 In CCPs' rulebooks, CCPs generally have arrangements for cash calls in default loss scenarios. These are usually placed after the prefunded default fund but before the use of VMGH (where present) in the CCP's default waterfall. Each clearing member's contribution is typically capped at a multiple of 1x their contribution to the prefunded default fund. In addition to this, a CCP generally also has the power to conduct a further voluntary

cash call, before being expected to conduct a full tear up of contracts and service closure.

- A.63 In a resolution scenario, the Bank is constrained by the limits on the cash calls contained within the CCP's own rules and arrangements, which may not offer sufficient loss absorbency.
- A.64 This proposal introduces a statutory power to enable the Bank to conduct a cash call in a default loss scenario. This would also be included in the CCP's rulebook but should be reserved for the RA in a resolution.
- A.65 This statutory cash call power would allow the Bank to make cash calls on clearing members in excess of the limits on the cash calls contained within the CCP's default management arrangements under the rulebook, subject to the NCWO safeguard. This is consistent with the power for the Bank to deviate from a CCP's rules and arrangements.
- A.66 The quantum of this default loss cash call would be capped at two times an individual clearing member's contribution to the prefunded default fund. This would be subject to the NCWO safeguard.

Statutory cash call power in a non-default loss scenario

- A.67 FSB guidance states that, in a non-default loss scenario, a statutory cash call could be exercised 'if the non-default losses are not fully absorbed by writing down the CCP's equity and applying any other loss allocation measures available under the CCP's rules and arrangements for non-default losses'.
- A.68 Whilst not a mandatory power in FSB guidance, it would be beneficial for the Bank to have the power to conduct a cash call in a non-default loss scenario to address outstanding losses, and recapitalise the CCP, returning it to above the minimum regulatory capital threshold without relying on the use of public funds. A cash call is likely to be less disruptive to the market than a write down of unsecured liabilities. Having this tool, in addition to the power to write down unsecured liabilities (set out in more detail below), would allow the Bank flexibility to allocate losses in resolution through the mechanism that it judges to be least disruptive, taking into account the circumstances at the time. Use of both the cash call and the write down power, as with all resolution powers, would be subject to the NCWO safeguard.
- A.69 The proposal introduces a statutory power enabling the Bank to conduct a cash call in non-default loss scenarios. Consistent with the default loss cash call, this should also be included in the CCP's rulebook, but should be reserved for the RA in a resolution.
- A.70 This cash call would be exercisable only after the exhaustion of the CCP's equity and the application of any arrangements in the CCP's rulebook for non-default losses.
- A.71 The quantum of this cash call would be capped at three times each clearing member's prefunded contribution to the default fund, given that the proposal does not include a VMGH power for non-default losses. This should

allow clearing members to always understand the maximum amount that they may be required to contribute under any such cash call.

Box A.3: Do you agree with the proposal to limit the statutory VMGH power to default loss scenarios, and instead have a larger cap on the cash call for non-default loss scenarios?

Power to write down and convert unsecured liabilities

- A.72 FSB guidance states “The resolution authority should have the power to write down, where appropriate, unsecured liabilities in accordance with the creditor hierarchy in insolvency and, if appropriate, convert them into equity or other instruments of ownership of the CCP or of a successor entity to absorb losses and to replenish the capital of the CCP or a successor entity.”
- A.73 An unsecured liability is a liability that carries no collateral, and so is not secured by an asset. Writing these liabilities down means that the value of the liability is adjusted. They can then be converted, if appropriate, into an instrument of ownership given to clearing members. This represents a general write down power, as described in the FSB guidance.
- A.74 Under the current regime, the Bank does not have the power to write down unsecured liabilities. This power would allow the Bank to generate additional loss absorbing capacity to execute a resolution (in particular, one resulting from a non-default loss event). This additional flexibility for the Bank is important in a non-default loss scenario, particularly given that the proposal does not permit the use of VMGH.
- A.75 The proposal introduces a power for the Bank to write down, and if appropriate convert, unsecured liabilities (e.g. default fund contributions). The Bank does not envision using this tool in a default loss scenario, where a cash call or VMGH could more appropriately be used to achieve the same loss absorbency.
- A.76 Therefore, the Bank would be able to exercise this power to absorb an outstanding loss where a non-default loss is not already fully absorbed by any of: the resolution cash call; writing down the CCP’s equity; or applying any other loss allocation measures for non-default losses available under the CCP’s rules and arrangements. The write down power could also be used to return the CCP to the minimum regulatory capital threshold.
- A.77 The proposal would introduce limits to the scope of the write down and conversion tool to ensure liabilities are not written down or converted which would be detrimental to the functioning of a CCP’s operations or systems. This is also necessary to avoid giving rise to widespread contagion.
- A.78 The power would be limited to prevent the Bank from being able to write down the following liabilities: liabilities to employees; liabilities to commercial or trade creditors arising from the provision to the CCP of goods or services that are critical to the daily functioning of its operations; liabilities to tax and social security authorities; liabilities owed to systems or operators of systems designated to participants (e.g. settlement systems) to the extent

that the liabilities result from their participation in such systems, to other CCPs and to central banks; and initial margins.

- A.79 Initial margins should be out of the scope of the power because writing down initial margin would leave positions uncovered, meaning open positions would either have to be reduced (e.g. through a tear up) or clearing members would have to top up the margin requirements with potential procyclical effects. Haircutting of initial margins may also present risks to netting. As with other powers, this would be also subject to the NCWO safeguard

Other powers

Power to delay enforcement of a clearing member's obligation

- A.80 Currently, the Bank does not have the power to delay the enforcement of a clearing member's obligation. The proposal would give the Bank the power to delay the enforcement of an obligation placed on a clearing member. This would include delaying the enforcement of a clearing member's obligation to meet a statutory resolution cash call.
- A.81 This power enables the Bank to delay enforcement of a clearing member's obligation for up to 18 months should enforcement during the resolution of the CCP present a risk to financial stability. The Bank would also have the power to enforce the outstanding obligations resulting from such a delay in enforcement at any time up to 18 months after the resolution, if at the relevant time the reasons for refraining from their enforcement no longer exist. If the Bank does not enforce an outstanding obligation within this 18-month period, the obligation will lapse at the end of it.
- A.82 Delayed enforcement could create greater market volatility. However, given the uncertain nature of a CCP resolution, it is appropriate that the Bank has the flexibility to use this tool should it be appropriate. For instance, it could be appropriate to use this tool should a clearing member be unable to meet its resolution cash call obligations due to short-term liquidity problems.

Box A.4: Do you agree with the proposed power to delay the use of resolution tools for up to 18 months and its current scope?

Replenishment

- A.83 FSB guidance requires that the RA should have the powers and tools to ensure a CCP's financial resources are replenished within an appropriate time frame to ensure the maintenance of regulatory approval. Reflecting this in the UK regime would enable the use of VMGH, cash calls and write down powers to generate funds to replenish the CCP's resources to the level necessary to meet its statutory obligations, and continue to provide its critical services in a timely manner.
- A.84 Under onshored EMIR, the Bank, as the supervisor of UK CCPs, can withdraw the authorisation of a CCP that fails to comply with its onshored EMIR requirements, which include a regulatory capital requirement (Article 20) and

require a CCP to take action to fix a breach of onshored EMIR requirements (Article 21(5)).

- A.85 However, the Bank would not currently be able to use its resolution tools to generate the necessary funds to recapitalise a CCP.
- A.86 The proposed regime would introduce a power enabling the Bank to use statutory loss allocation tools (VMGH, cash calls and write down powers) to replenish the CCP's resources to the level necessary to meet its statutory obligations, in addition to absorbing losses, within the constraints of the NCWO safeguard. This should allow the Bank to ensure that financial resources are replenished within an appropriate timeframe in order for the CCP to meet its obligations under Article 16 and Article 45 onshored EMIR. As a consequence, this should allow the CCP to meet the conditions for its continued authorisation, allowing it to continue to operate its critical clearing services.

Clearing member compensation

- A.87 FSB guidance requires that the RA should have the power to compensate clearing members that contribute financial resources to a resolution in excess of their obligations under the CCP's rules and arrangements.
- A.88 The proposal ensures that clearing members are eligible to recoup losses suffered as a result of providing resources for loss absorption and/or recapitalisation of a CCP in excess of the loss they would have experienced under the NCWO counterfactual.
- A.89 Insolvency law establishes a creditor hierarchy that determines the order in which losses are allocated in liquidation. This should also be applicable for loss allocation for the purposes of compensation, such that those who suffered the first loss in resolution should be the last to be compensated.
- A.90 After CCP resolution, an independent expert third-party entity should conduct a NCWO valuation to determine if any clearing members are due compensation as a result of the NCWO safeguard. Consistent with the Banking Act 2009, as it currently applies to non-CCPs, this third-party entity must be appointed by a person (individual or panel) appointed by HMT. The Special Resolution Code of Practice for the Banking Act sets out further detail on this appointment process, and appropriate criteria for appointment. The code of practice should be amended to set out the same detail in Chapter 13 for the purposes of CCP resolution.
- A.91 The independent valuer should assess the hypothetical financial outcome for clearing members under the NCWO counterfactual. This should be compared against the actual financial outcome for clearing members as a result of resolution, which will determine the validity of any compensation claims, and the size of these. The Bank will set out a clear and transparent calculation methodology, where indirect costs will not be taken into account in the counterfactual, providing greater protection and certainty for clearing members.
- A.92 Following this valuation, compensation could take the form of, depending on contractual arrangements: proceeds from the delayed enforcement of a

clearing member's obligations; claims on a share of the CCP's future profits; revenue resulting from the sale of the CCP; equity in the CCP; or potentially, as a last resort, public funds.

- A.93 The overall aim of the regime is to protect public funds by minimising reliance on extraordinary public financial support and the potential risk of losses for taxpayers. Thus, any use of public funds for compensation would be the very last resort and would be subject to explicit consent from HMT.
- A.94 Where clearing members are compensated with future profits or equity of a CCP, this reduces the immediate risk to public funds. It also provides an incentive for clearing members to continue clearing and reintegrate the CCP into the financial system.
- A.95 If a clearing member is compensated, they should not be mandated to compensate their clients. This protects the relationship between clearing members and clients, which should be a private contractual agreement which will govern any rights and obligations regarding the pass through of compensation from the clearing member to its underlying client. Clients will only be entitled to a direct claim where they are a direct creditor of the CCP.
- A.96 Clearing members and CCPs should be responsible for negotiating between themselves the precise nature of any contractual arrangement which would entitle clearing members to a claim on future profits or equity. The Bank would have oversight over these arrangements, given that public funds could ultimately be at risk.
- A.97 Equity and future profits can also be used by the Bank as tools to compensate clearing members in circumstances where clearing members have not been left worse off than under the NCWO counterfactual, irrespective of whether an agreement was made contractually or not. Compensating clearing members might encourage a faster and more voluminous return to clearing and normal market behaviour, thereby promoting financial stability. Should a clearing member voluntarily provide funds to recapitalise the CCP and replenish the minimum capital requirements, it could be appropriate (and even beneficial) to compensate the clearing member, since they would not be covered for this action under the NCWO counterfactual.

Box A.5: Do you agree with the modalities of the proposed compensation process?

Annex B

Privacy Notice

Processing of Personal Data

- B.1** This notice sets out how HM Treasury will use your personal data for the purposes of Expanded Resolution Regime for Central Counterparties (CCP) consultation and explains your rights under the General Data Protection Regulation (GDPR) and the Data Protection Act 2018 (DPA).

Your data (Data Subject Categories)

- B.2** The personal information relates to you as either a member of the public, parliamentarians, and representatives of organisations or companies.

The data we collect (Data Categories)

- B.3** Information may include your name, address, email address, job title, and employer of the correspondent, as well as your opinions. It is possible that you will volunteer additional identifying information about themselves or third parties.

Legal basis of processing

- B.4** The processing is necessary for the performance of a task carried out in the public interest or in the exercise of official authority vested in HM Treasury. For the purpose of this consultation the task is consulting on departmental policies or proposals or obtaining opinion data in order to develop good effective government policies.

Special categories data

- B.5** Any of the categories of special category data may be processed if such data is volunteered by the respondent.

Legal basis for processing special category data

- B.6** Where special category data is volunteered by you (the data subject), the legal basis relied upon for processing it is: the processing is necessary for reasons of substantial public interest for the exercise of a function of the Crown, a Minister of the Crown, or a government department.
- B.7** This function is consulting on departmental policies or proposals, or obtaining opinion data, to develop good effective policies.

Purpose

- B.8** The personal information is processed for the purpose of obtaining the opinions of members of the public and representatives of organisations and companies, about departmental policies, proposals, or generally to obtain public opinion data on an issue of public interest.

Who we share your responses with

- B.9** Information provided in response to a consultation may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 2018 (DPA) and the Environmental Information Regulations 2004 (EIR).
- B.10** If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence.
- B.11** In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury.
- B.12** Where someone submits special category personal data or personal data about third parties, we will endeavour to delete that data before publication takes place.
- B.13** Where information about respondents is not published, it may be shared with officials within other public bodies involved in this consultation process to assist us in developing the policies to which it relates. Examples of these public bodies appear at: <https://www.gov.uk/government/organisations>
- B.14** As the personal information is stored on our IT infrastructure, it will be accessible to our IT contractor, NTT. NTT will only process this data for our purposes and in fulfilment with the contractual obligations they have with us.

How long we will hold your data (Retention)

- B.15** Personal information in responses to consultations will generally be published and therefore retained indefinitely as a historic record under the Public Records Act 1958.
- B.16** Personal information in responses that is not published will be retained for three calendar years after the consultation has concluded.

Your Rights

- B.17** You have the right to request information about how your personal data are processed and to request a copy of that personal data.
- B.18** You have the right to request that any inaccuracies in your personal data are rectified without delay.

- B.19 You have the right to request that your personal data are erased if there is no longer a justification for them to be processed.
- B.20 You have the right, in certain circumstances (for example, where accuracy is contested), to request that the processing of your personal data is restricted.
- B.21 You have the right to object to the processing of your personal data where it is processed for direct marketing purposes.

How to submit a Data Subject Access Request (DSAR)

- B.22 To request access to personal data that HM Treasury holds about you, contact:

HM Treasury Data Protection Unit
G11 Orange
1 Horse Guards Road
London
SW1A 2HQ

dsar@hmtreasury.gov.uk

Complaints

- B.23 If you have any concerns about the use of your personal data, please contact us via this mailbox: privacy@hmtreasury.gov.uk.
- B.24 If we are unable to address your concerns to your satisfaction, you can make a complaint to the Information Commissioner, the UK's independent regulator for data protection. The Information Commissioner can be contacted at:

Information Commissioner's Office
Wycliffe House
Water Lane
Wilmslow
Cheshire
SK9 5AF

0303 123 1113

casework@ico.org.uk

Any complaint to the Information Commissioner is without prejudice to your right to seek redress through the courts.