

Joint FMI proposal for enhanced communications in the event of resolution of an FMI participant

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1. Introduction

In light of the critically important role that financial market infrastructures (“FMIs”) play in the financial ecosystem, and the emphasis regulators have placed on a bank in resolution to maintain access to FMIs¹, a group of FMIs (the “Participating FMIs”)² came together in 2019 to identify steps that FMIs, authorities and other stakeholders might take to maximize the likelihood of continued safe access for a bank or bank affiliate in resolution. That being said, consistent with FSB Guidance, in order to support financial stability, an FMI must maintain its rights, as provided under its rulebook, to take the actions necessary to restrict, suspend or terminate access where a participant or its parent does not meet its membership/participation requirements and/or terms and conditions.

Further to this goal, the Participating FMIs conducted their own respective “resolution war game” exercises based upon a shared bank resolution scenario (the “Scenario”), briefly described below.³ As a result of these exercises, the Participating FMIs identified the need for additional clarity and transparency regarding a participant in resolution’s ability to meet its obligations to FMIs. They also agreed that enhanced communications between the resolution authority and FMIs at all stages of the resolution process (as set forth below), would be beneficial and maximize the likelihood of continuity of access. The Participating FMIs also believe that additional industry-wide testing, potentially based on shared scenarios, is extremely important and would allow authorities, FMIs, and FMI participants to continue identifying and addressing potential impediments to successful resolution.

2. The scenario

Each FMI’s war game exercise was based upon the assumption that a hypothetical Dutch participant, “ABC Dutch Bank” (a global systemically important bank, or a “G-SIB”) became subject to resolution under the management of the resolution authorities, the Single Resolution Board (the “SRB”) and De Nederlandsche Bank (“DNB”),⁴ using the bail-in tool. A hypothetical public notice (the “Public Notice”) was published by the SRB and DNB at 17:00 CET Saturday evening 2 November 2019 (during the hypothetical resolution weekend), and it was assumed that the FMIs and the wider market learned about the bail-in at that time via the publication of the Public Notice.

The Public Notice specifically provided that ABC Dutch Bank, following the implementation of the resolution scheme, would meet and exceed its capital requirements, and that ABC Dutch Bank and its branches and subsidiaries in the European Union and all other jurisdictions would continue to operate under normal business conditions with immediate effect. The

¹ Please refer to (i) the Guidance on Continuity of Access to Financial Market Infrastructures (‘FMIs’) for a Firm in Resolution issued by the Financial Stability Board in July 2017 (the “FSB Guidance”), available at <https://www.fsb.org/wp-content/uploads/P060717-2.pdf> (ii) ‘Appendix II: Sector-specific Guidance - II-Annex 1: Resolution of Financial Market Infrastructures (FMIs) and FMI Participants’ to the Key Attributes of Effective Resolution Regimes for Financial Institutions, <https://www.fsb.org/2014/10/key-attributes-of-effective-resolution-regimes-for-financial-institutions-3/>, dated 15 October 2014 (the “Key Attributes”).

² Clearstream, CLS Bank International (“CLS”), Chicago Mercantile Exchange Inc., EBA Clearing, Eurex Clearing AG, and Euroclear.

³ The Participating FMIs note that subsequent to the war game exercises, the FSB published in 2020 a questionnaire for completion by FMIs entitled “FSB Continuity of Access to FMIs for Firms in Resolution Streamlined information collection to support resolution planning.” The Participating FMIs support an approach that will further a shared and transparent understanding between and among stakeholders, including participants, primary regulators, resolution authorities, and FMIs, in order to maximize the likelihood that a participant (including its affiliates, if any) in resolution could continue to safely access the relevant FMIs.

⁴ Under the resolution framework in the European Banking Union, the SRB is the primary resolution authority for: (i) banks that are considered significant or in relation to which the European Central Bank has decided to exercise directly all of the relevant supervisory powers (e.g., ABC Dutch Bank); and (ii) other cross-border groups, where both the parent and at least one subsidiary bank are established in two different participating Member States of the European Banking Union. The relevant national resolution authority (e.g., DNB, in this hypothetical scenario) must take the necessary actions to implement the resolution scheme that is set by the SRB.

Public Notice further provided that ABC Dutch Bank was expected to meet its substantive obligations and maintain continuity of access to the FMI which it operated. As part of the Scenario, the SRB and DNB verified that ABC Dutch Bank had sufficient financial resources to “meet its obligations as they fall due.”

It was also assumed that either ABC Dutch Bank or one of its affiliates (as applicable) participated directly in each of the Participating FMIs. The actual exercise conducted by each of the Participating FMIs varied greatly depending on the specific structure of each FMI and its contractual relationship with ABC Dutch Bank or its affiliates.

3. The outcome

As noted above, each of the Participating FMIs conducted its own resolution war game exercise consistent with its rules, policies and procedures and the markets served by the FMI. The majority of the Participating FMIs conducted the war game with internal participants, including relevant Board members and experts from relevant areas. The war game was presented to them as if it were 17:00 CET Saturday evening 2 November, in order to discuss how they would react in this situation, and which, potential actions, they would take, as well as to identify potential issues and how to overcome these issues. CLS also included certain members in the exercise, and directly incorporated their feedback into its ultimate decision-making process over the course of the war game.⁵

The main outcomes of the Participating FMIs’ war game exercises were as follows:

- Based on the key assumption that all obligations towards the FMI were met in a timely manner, the direct participant in resolution continued to have access to all FMIs (other than CLS, where instructions submitted by ABC Dutch Bank were deferred to the next business day - please refer to footnote 5 below for additional detail).
- Direct communications between the resolution authority and the FMIs is crucial.
 - Not knowing the liquidity situation of ABC Dutch Bank during and post-resolution was identified as a potential issue, including potentially in an actual resolution.
 - The Public Notice contained very detailed information on ABC Dutch Bank’s resolution. This was seen as extremely useful, even if it was questioned if this level of detail would be realistic in an actual public notice in a resolution scenario.
 - In the absence of certainty as to when any resolution will commence, it is important for FMIs to be advised regarding what they can reasonably anticipate in a resolution scenario (e.g., greater likelihood that a resolution would commence during a weekend) and that timely, specific and effective (if not targeted) communications means will be used by authorities to inform FMIs specifically (taking into account, e.g., potential challenges for relevant stakeholders as a result of out-of-office hours communication).⁶

⁵ CLS assigned participating members the role of hypothetical “other members” and hypothetical “nostro agents” acting on behalf of ABC Dutch Bank and assigned these participants detailed hypothetical profiles, including numerous assumptions. Over the course of the resolution weekend CLS failed to receive sufficient comfort from certain hypothetical nostro agents that they would be prepared to fund on behalf of ABC Dutch Bank in relevant currencies (i.e., CLS sought to test the assumption that obligations would be met). As a result of this fact, CLS deferred settlement of the payment instructions submitted by ABC Dutch Bank to the next business day. CLS notes that this outcome was specific to the facts and circumstances of this war game exercise (including the assumptions provided to the hypothetical nostro agents and time limitations) and might differ in reality.

⁶ While there may be certain additional challenges as a result of a resolution taking place over a weekend, a resolution commencing over the course of a weekend is still preferable over a resolution commencing during the work week, including (but not limited to) the additional flexibility (in terms of time, as markets are closed) afforded to, e.g., FMIs to respond to the situation, as well as mitigating initial adverse reactions by other market participants.

- Missing an FMI's internal deadlines could have significant consequences for the resolution scheme, which could ultimately lead to the suspension or termination of a participant, where it (or its parent) enters into an actual resolution.
- One FMI specifically noted that there may be an operational challenge with respect to securities that would need to be written down or exchanged into new securities (in the context of the bail-in/resolution) which might be held in different CSDs across the group and/or outside of the group and therefore could require cross-border coordination.

4. Suggestions

4.1 Push messages

One of the key conclusions derived from the war game exercises carried out by the Participating FMIs related to the Participating FMIs' reliance on information regarding ABC Dutch Bank's entry into resolution, published by the resolution authorities in the hypothetical Public Notice. While the scenario assumed for purposes of the exercise that the FMIs were aware of the commencement of the resolution upon publication of the notice, in reality this may not have been the case. It is currently not foreseen that if an FMI participant (or its parent) enters resolution, that there will be direct push communications at the time of publication of the release of the public notice, although the use of such communications would be welcome.

From a European perspective, public notices of resolution actions are typically published on the website(s) of the relevant (national/supranational) resolution authorities (over 40 different authorities in the sole EU/EEA/UK context).⁷ Accordingly, FMIs must proactively search the websites of the relevant authorities. Given that a resolution might occur at any moment (especially outside standard business hours over a resolution weekend or evening), this creates a high risk of delayed awareness by FMIs should an FMI participant (or its parent) enter into resolution. Further, it inevitably leads to FMIs (located in different jurisdictions and time zones) becoming aware at different times. This delayed and asynchronous knowledge could significantly hamper FMIs' individual and collective ability to carry out all necessary actions efficiently and in a timely manner, in order to provide for continuation of access (to the extent practicable) to the entity under resolution.

As advised by the Key Attributes, "resolution authorities should inform FMIs as soon as possible of the resolution of a participant, and if possible in advance of the firm's entry into resolution."⁸ Therefore, it is the Participating FMIs' shared belief that a more efficient, effective and direct communication procedure should be developed by resolution authorities in all jurisdictions, whereby all types of FMIs, wherever located, would directly receive a 'push notification' of the relevant resolution, at the latest upon public disclosure of the resolution, but preferably in advance. Advance notification would serve to mitigate potential concerns among market participants, as the FMIs would have time to prepare actions and respond to public inquiries in a timely manner.

Described below is an example of how the enhanced notification procedure for resolution notifications could be set up in the EU. However, as noted above, the Participating FMIs believe that notification is equally important in connection with all jurisdictions and all legal regimes, and not just the EU.

⁷ Jurisdictions outside the EU/EEA/UK take different approaches, but we understand that notice of resolution will typically be conveyed by the publication of a notice.

⁸ Please refer to the Key Attributes, Appendix II: Sector-specific Guidance - II-Annex 1: point 5.1, page 73.

EU Example.

It is potentially helpful to look at the Settlement Finality Directive (“SFD”) in the EU.⁹ The paragraphs below summarize the current process for the notification of insolvency proceedings to FMIs designated pursuant to the SFD.

Article 6 of the SFD sets out the principles of notification of insolvency proceedings for a participant in an SFD-designated payment or securities settlement system:

- Ex ante:
 - As part of the SFD designation process, FMIs provide and regularly update specific contact details (including key contacts) notified by national authorities to the European Securities and Markets Authority (“ESMA”).
- Day-D (i.e., “Day-0”):
 - The opening of insolvency proceedings is handed down by a judicial or administrative authority in EU Member State X (art. 6(1)).
 - This judicial or administrative authority in this Member State X sends a notification to the appropriate ‘SFD authority’ in EU Member State X (art. 6(2)).
 - The ‘SFD authority’ in EU Member State X notifies the opening of insolvency proceedings to the European Systemic Risk Board (“ESRB”), ESMA, appropriate ‘SFD authorities’ in other Member States (art. 6(3)) – and to FMIs in EU Member State X; and
 - Appropriate ‘SFD authorities’ in the other EU Member States notify all of ‘their’ FMIs. Upon receipt of the notification, FMIs execute the insolvency procedures as laid down in their respective rules.

In the context of the EU, in order to improve the speed, simultaneity and completeness of notifications, the Participating FMIs suggest that resolution authorities align with and enhance the SFD process as above, by immediately notifying all relevant FMIs of a resolution decision. At the EU level, this immediate notification could be achieved by the relevant home resolution authority/is sending (push) messages (i.e., an email referring to the public notice and authority’s website) to all SFD-designated FMIs, leveraging the list of contact details that FMIs have provided for SFD purposes. EU authorities, such as ESMA or the SRB, could send or relay the message to FMIs in the EU. At the global level, the principle could be the same, relying on cross-border home-host authorities’ cooperation and ex-ante collection and exchange of FMI contact details. Most importantly, FMIs could be required to keep the notification confidential.

The active role of resolution authorities will have a significant impact in terms of timeliness of notification to FMIs, thus allowing for a more immediate response to the resolution event, which could increase the likelihood of the participant’s continued access to FMIs in case of resolution (as long as, at a minimum, obligations to the FMI pursuant to its rulebook and contractual arrangements would continue to be met). This will promote financial stability in a wider cross-border context and across systems.

4.2 Additional critical communications

The outcome of the resolution war game served to highlight the importance of communication and coordination between regulators, FMIs and other relevant stakeholders in the event of a bank (particularly a G-SIB) entering resolution, where it, or one of its subsidiaries is a direct

⁹ The Participating FMIs believe that notice is equally important for all jurisdictions and is highlighting the EU as just one example.

participant in an FMI. In particular, communication and sharing of critical information between all stakeholders before, during and after resolution would be useful with respect to the points below: (i) between and among authorities, both on a domestic and cross-border basis; and (ii) from authorities to FMIs.

In the war game exercise, in accordance with each of the Participating FMI's rulebooks, ABC Dutch Bank's entrance into resolution was not a termination or default trigger event for any of the Participating FMIs, either automatic or discretionary (as long as, at a minimum, obligations towards the FMI pursuant to its rulebook were and would continue to be met). In reality, though, access to the FMIs may be terminated, defaulted or suspended, if the participant can no longer abide by the rules of the FMI (e.g., timelines for collecting margin), if maintaining continuity of access would be counter to the FMI's objective to support financial stability. The timely sharing of information from relevant authorities to FMIs could help to prevent this. Accordingly, the Participating FMIs believe that it would be helpful for resolution authorities to familiarize themselves with the timelines of relevant FMIs during the resolution planning phase.

In conducting the war game exercises, the Participating FMIs recognized the value of authorities communicating with each other, both domestically and on a cross-border basis. This is particularly important in the case where the primary regulatory authorities are different for the FMI and FMI participants, which may be due to a given jurisdiction having different prudential and market authorities, or authorities being domiciled in different jurisdictions. Consistent with the FSB Guidance, establishing communication protocols between authorities in all relevant jurisdictions (which might include jurisdictions where the bank in resolution has relationships, such as nostro agents, but does not have a material presence) in advance of an FMI participant's distress will assist in facilitating cooperation to support financial stability in the lead-up to and during the event of an FMI participant (or its parent) entering into resolution. Should such a resolution event occur, it is of the utmost importance that information is shared between authorities as soon as possible, as noted in the FSB Guidance:

"Resolution and supervisory authorities of FMI service users should have in place appropriate information sharing arrangements with the relevant authorities of providers of critical FMI services. The relevant resolution and supervisory authorities and the relevant authorities of providers of critical FMI services should seek to give each other as much advance notice as possible about intended actions and possible risks with regards to maintaining continuity of access."¹⁰

Information-sharing between authorities allows for information to be effectively shared with an FMI, assuming that information is timely conveyed to the FMI from its relevant authorities (in addition to any direct communications from the resolution authorities to the FMIs, which the Participating FMIs also believe is very important). The Participating FMIs recognize that the more information an FMI has surrounding the facts and circumstances of a given participant's resolution, the more likely they will be able to effectively support the participant's continued access in resolution and promote the stability of the broader financial system. The Participating FMIs recognize that the sharing of certain information would be impacted by the facts and circumstances underpinning the resolution event. With this understanding, the Participating FMIs have endeavored to identify considerations and areas of information that would be helpful to an FMI with respect to the resolution of an FMI participant (or its parent). These include, but are not limited to:

¹⁰ FSB Guidance, point 3.3, page 21.

- In advance of resolution, identify: (i) primary points of contact at the FMI and at the FMI participant – e.g., identify whether the FMI could continue to engage with its “business-as-usual” and back-up contacts or whether contacts have changed as a result of the resolution; (ii) which entities (e.g., broker-dealer) of an FMI participant (or its parent) are considered material legal entities with respect to participation in the FMI; and (iii) which of the FMI participant’s (or its affiliate) services of an FMI participant (or its affiliate) play critical roles for the FMI and its ecosystem (e.g., as nostro agent or cash correspondent);
- Notification to an FMI, as soon as practicable, that a participant (or its parent) is entering into resolution (please see the section above, regarding push notifications), preferably in advance of the public notice in an effort to minimize adverse reactions and maximize the likelihood of safe and orderly continued access to FMIs;
- Intended timing of release of critical information by the resolution authority – e.g., if predefined items for release are determined and timing of such release;¹¹
- “Resolution tools” that, if used, would impede continued participation in the FMI or would result in systemic risk;
- Whether certain services, particularly those provided to an FMI (and/or to FMI participants), will be delayed or cease to be provided should an FMI participant (or its parent) enter into resolution (e.g., settlement and custody banking services, providing liquidity, etc.);¹²
- Updated financial and organizational information, as it becomes available, on an FMI participant (or its parent) that is subject to resolution;
- Implications for FMIs as to if and when (as well as how long) liquidity will flow to or from an FMI participant (or its parent), particularly relative to satisfying obligations to the FMI, including obligations in multiple currencies;
- Implications for FMIs as to the treatment of assets of an FMI participant, including in a single point of entry scenario where the parent is subject to resolution in another jurisdiction; and
- Implications for FMIs with respect to the use of differing resolution strategies – some of the strategies may have implications for certain FMIs that must be considered and addressed prior to resolution (e.g., bail-in versus bridge bank as resolution tools).

The manner in which and when this information would be shared with an FMI should ideally be established on an ex-ante basis – e.g., the FMI receives information from its primary regulator, the FMI participant’s primary regulator, and/or the FMI participant’s home resolution authority and the participant’s resolution authority, etc.

In addition to communication between authorities and FMIs, the Participating FMIs also recognize the benefits of sharing non-confidential information between FMIs in the event of an FMI participant (or its affiliate) entering into resolution (e.g., confirming the entry into resolution and also conveying some of the types of information listed above, including the roles that the FMI participant will play in the FMI’s ecosystems going forward). Because of the differences in jurisdictions and time zones, it is possible that FMIs may not have access

¹¹ The Participating FMIs believe it is critical for resolution authorities to engage directly with FMIs to understand which information is absolutely essential for each specific FMI and to ensure that such information is provided immediately to each FMI upon the entry of a participant into resolution (e.g., for CLS, providing assurance that the participant in resolution will be able to meet its funding obligations in all relevant currencies, which is dependent upon the agreement of nostro agents in relevant jurisdictions to continue to fund).

¹² Since banks may play multiple roles in each FMI’s “ecosystem” (e.g., acting as a third-party service provider to enable access to the FMI’s services for other entities), it is critical for FMIs, third parties and authorities to understand if any of those roles will change. This will have implications for the wider ecosystem.

to critical information at the same time. Sharing this information could help to mitigate associated risks.

4.3 Non-disclosure agreements (“NDAs”) with FMIs, as necessary and appropriate

As noted above, the FSB has advised in its Key Attributes that resolution authorities should inform FMIs of the resolution of an FMI participant as soon as possible, and if possible, in advance of the firm’s entry into resolution; notice to FMIs is critical and advance notice would be particularly beneficial.

However, to date resolution authorities have generally not taken the position that advance notice will be provided to FMIs. The Participating FMIs suggest that authorities reconsider this position and assess the merits of entering into NDAs with FMIs to facilitate the sharing of information that is necessary and appropriate for each FMI/type of FMI, since the FMIs would be obligated to keep resolution-related information confidential – in this manner, authorities would have the option (but not the obligation) to disclose information to FMIs in the event they determine such disclosure would be beneficial for the success of the specific resolution or to prevent systemic impacts (e.g., by increasing the likelihood that the participant in resolution will be able to continue to participate in the FMI and/or confirming that the participant will continue to play a critical role in that FMI’s ecosystem, which will have an impact on the FMI’s other participants).

For example, in the event an NDA has been entered into, the resolution authority might wish to notify similarly situated FMIs on Friday evening, as opposed to a Saturday evening (assuming a similar scenario to the war game Scenario) of the impending resolution. With respect to the CLS system, for example, entry into an NDA would afford the resolution authority the opportunity to send funds to CLS on Friday, as deemed necessary and appropriate by the authority, prior to the close of relevant Real Time Gross Settlement (RTGS) systems.

Conversely, the NDAs could potentially enable the authority to obtain important information from FMIs prior to resolution (e.g., projections for the upcoming resolution weekend), if necessary, subject to applicable laws and relevant agreements.

Thank you for your consideration of these important points.