LCH.CLEARNET

Prudential Policy Department
Monetary Authority of Singapore
10 Shenton Way, MAS Building
Singapore 079117

JUL 24 2015

Dear Sirs,

CONSULTATION PAPER P011-2015: PROPOSED ENHANCEMENTS TO RESOLUTION REGIME FOR FINANCIAL INSTITUTIONS IN SINGAPORE

This letter provides the submission of LCH.Clearnet Ltd ("LCH.Clearnet") to MAS's June 2015 Consultation Paper on Proposed Enhancements to Resolution Regime for Financial Institutions in Singapore.

LCH.Clearnet is a subsidiary of the LCH.Clearnet Group, one of the world's leading clearing house groups, which serves major international exchanges and platforms, as well as a range of OTC markets. It clears a broad range of asset classes including cash equities, exchange traded derivatives, commodities, energy, freight, interest rate swaps, credit default swaps, bonds, repos, and foreign exchange derivatives. The Group's central clearing counterparties ("CCPs") have over 190 clearing members and over 600 clients across 22 countries.

LCH.Clearnet's primary regulator is the Bank of England, which has authorised it to operate throughout the EU in accordance with the European Markets Infrastructure Regulation (EMIR). LCH.Clearnet is also registered as a Derivatives Clearing Organization (DCO) with the Commodity Futures Trading Commission (CFTC) in the USA. Furthermore, it is also regulated in Australia, US, Quebec and Ontario, and has applied for recognition or licensing in a number of other jurisdictions.

As a global multi-currency clearing house, LCH.Clearnet has an interest in the policy frameworks for CCP recovery and resolution that exist or are under development in each of the jurisdictions in which it does or may operate.. We welcome MAS's consultation on resolution for Financial Institutions and have provided responses to those questions most relevant to our business.

We note that MAS's powers (under the Monetary Authority of Singapore Act) include resolution powers over recognised clearing houses. As you are aware,

LCH.Clearnet has applied to MAS for recognition as a clearing house in Singapore, however our primary regulator is and will remain the Bank of England. Under legislation that came into effect on 1 August 2014 bringing into force the provisions in the (UK) Financial Services Act 2012 that extend the UK's Special Resolution Regime to cover UK CCPs, the Bank of England also has powers to resolve a failing UK CCP.[1]

Recovery and Resolution Plans

1. MAS seeks views on the proposal for legislative amendments that will subject notified financial institutions that are systemically important or maintain critical functions, to the requirements in paragraph 2.2(a) to (e).

The requirements in paragraphs 2.2(a) to (e) are sensible, however we recommend that the final rules include an exemption for those recognised clearing houses which already comply with the obligation to have a recovery plan in place under their home jurisdiction. For example, LCH.Clearnet already maintains a recovery plan under UK Statutory requirements and reviews it regularly as required by the Bank of England to ensure it remains relevant to LCH.Clearnet's operations. We also expect shortly a European proposal which will require all EU CCPs to establish recovery plans. Once in force, LCH.Clearnet will comply with the EU requirement. The requirement for foreign recognised clearing houses to comply with both home and host recovery plans would seem disproportionate [room for conflict?].

We also note that the proposal includes a requirement for recognised clearing houses to furnish information or documents required for the purposes of resolution planning. We suggest that this requirement is amended so that for foreign recognised clearing houses MAS works with the relevant foreign competent authorities in the preparation of a resolution plan.

2. MAS seeks views on the proposal to impose the responsibility for ensuring compliance with RRP requirements on the financial institution's board and executive officers, with contravention by the financial institution and/or any of its board members and executive officers constituting an offence with penalties.

We agree with the proposal, however, as noted in the answer to the above question, the RRP in question should, we suggest, be that adopted by the foreign recognised clearing house in accordance with the requirements of their home regulator (where such an obligation is in force) in consultation with MAS.

Temporary Stays on Early Termination Rights on Financial Contracts

3. MAS seeks views on the proposal to introduce statutory powers to stay early termination rights of counterparties to financial contracts, in particular –

[1] http://www.legislation.gov.uk/uksi/2014/1828/made?view=plain

(a) the scope of financial contracts to be subject to the stay;

(b) the proposed duration of the stay and the circumstances in which it may be necessary to extend the duration of the stay in order to achieve an effective resolution or to support the stability of the financial system;

(c) the proposed safeguards to be introduced in connection with the stay as set out in paragraph 3.9 and whether any additional safeguards should be provided for; and

(d) whether the exercise of statutory powers to stay early termination rights for financial contracts of a distressed financial institution traded, cleared, settled or reported on a capital market infrastructure or DPS, as the case may be, will compromise the safe and orderly operations of the relevant capital market infrastructure or DPS and if so, how this may be mitigated.

We note that the authorities refer to the US and Canadian regimes but not the EU Directive on Recovery and Resolution of banks[2] in the consultation as examples of legislation already in force which includes provisions on temporary stay on early termination rights. We draw to MAS's attention that the EU Directive includes provisions to preserve the ability of a CCP to take action to default a participant in resolution, or the successor of a participant, that fails to perform its obligation to the CCP[3]. This is consistent with the FSB guidance which states unequivocally that: 'If a participant in resolution fails to meet any margin, collateral or settlement obligations to the FMI, the FMI should retain the right to exercise any acceleration or early termination rights that arise as a result of that failure[4]. We encourage MAS to adopt a similar approach in the Singapore framework.

In addition, a stay on early termination rights may be particularly important in resolution of CCPs. We support the approach outlined in the FSB guidance that the entry into resolution of an FMI should not in itself allow any counterparty of a FMI to exercise contractual acceleration and early termination rights, unless the FMI fails to meet payment or delivery obligations. We believe this approach is central to any successful CCP resolution.

To ensure that a stay on early termination rights effectively supports the resolution of a CCP, we suggest that the authorities consider the following. The resolution of a CCP may require the transfer of one or more clearing services to another CCP or a bridge institution and winding up of other, non-viable elements. Depending on the complexity of the CCP in resolution, it is difficult to envisage how long the implementation of these measures may take, and therefore we believe the authorities should recognise that there may be circumstances where the duration of a temporary stay enforced by them would need to be extended beyond a prescribed time, and this should also be reflected in the CCPs' rulebooks and membership agreements.

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[2] Directive 2014/59/EU
[3] Article 71(3)
[4] Section 3.1 at p. 73

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Ensuring Continuity of Essential Services and Functions

5. MAS seeks feedback on the proposal to introduce powers to ensure continuity of essential services and functions by suspending the termination rights of non-financial contracts, or requiring these contracts to be performed on the same terms and conditions that were in place prior to the resolution. Views are invited, in particular, on –

(a) the scope of non-financial contracts to be subject to such powers; and
(b) the potential implications on existing and future non-financial contracts.

We support the proposal to require service providers to continue to provide essential services to the a CCP in resolution, or any successor. A CCP would be adversely impacted in relation to general, unsecured creditors such as landlords, suppliers, IT vendors and potentially even staff who are crucial for keeping the CCP running if it is to continue as a going concern – if the moratorium on payment does not prevent the creditor in question from defaulting the CCP, or otherwise withholding the service it is supposed to be paying for. Indeed, the ability to resolve the CCP may be adversely impacted by the unavailability of crucial services required for the CCP's day to day operations.

Statutory Bail-in Regime

6. MAS seeks views on the proposal to introduce statutory bail-in powers under the MAS Act and for the bail-in powers to be first applied to Singapore-incorporated banks and bank holding companies.

We support the proposal to continue monitoring international developments before considering a bail-in regime for non-banks. While bail-in may be appropriate for a bank or other financial institutions we do not believe that it is appropriate for a CCP clearing house. CCP operators are typically equity-funded and under the relevant regulatory frameworks are obliged to hold high-quality, liquid resources. Instead of obliging the CCP to raise debt or contingent equity simply in order to be able to bail in, the priority should be to ensure that the CCP's regulatory capital is sized correctly in the first instance, and that there are sufficient pre-funded resources available to cover a member's default (i.e. margins and default fund contributions).

7. MAS seeks views on the proposal to apply the statutory bail-in regime to unsecured subordinated debt and unsecured subordinated loans, issued or contracted after the effective date of the relevant legislative amendments implementing the bail-in regime.

Paragraph 6.8 refers to liabilities owed to financial institutions and payment systems, and we propose that this should be extended to those owed to CCP clearing houses. The exclusion of such liabilities from any bail-in supports one of the objectives of an effective

resolution regime noted in the consultation paper and also in the FSB guidance[5] , which is to ensure continuity of systemically important clearing and settlement functions including those provided by CCPs. The ability of a CCP to continue to clear for a clearing member in resolution is indeed premised on the continued performance on obligations (such as the payment of margins) owed to the CCP by the clearing member or a successor firm.

We also believe that liabilities arising from derivatives cleared with a CCP should be excluded from any bail-in. We suggest that MAS clarifies this point in the final framework. Including liabilities arising from cleared derivatives in the scope of bail-in could have negative consequences, for example:

- Bail-in of the positions of a clearing member in resolution would leave the CCP with an unmatched book which is contrary to the fundamental design of CCPs. The existence of an unmatched book would complicate the efforts of the CCP to handle a potential default of the clearing member in resolution; and

- Bail-in of the collateral posted to the CCP to cover derivative contracts would reduce the resources available to the CCP to manage a potential default of the clearing member in resolution, jeopardising the effectiveness of a CCP's default procedures.

8. MAS seeks views on the proposal to complement the proposed statutory bail-in regime with contractual bail-in provisions for liabilities within the scope of MAS's statutory bail-in powers which are governed by the law of a foreign jurisdiction. MAS also seeks views on requiring banks to comply with the conditions set out in paragraph 6.11.

We do not believe that a CCP could agree that amounts owed to it by a member would be subject to bail-in for the reasons we set out above as to why CCPs should be exempt from bail-in generally. In relation to banks being required to comply with the conditions set out in paragraph 6.11, we believe this could be helpful to protect MAS' statutory powers as it would prevent creditors from bringing debt actions in other jurisdictions and then seeking enforcement of foreign courts' judgments in the Singapore courts..

10. MAS seeks views on the proposal for statutory powers to be introduced for MAS to either convert into equity or write down those instruments that are contingently convertible or which can be contractually bailed in, but whose terms and conditions for conversion or bail-in had not been triggered prior to entry into resolution.

We have no comment other than that we find it hard to imagine circumstances in which an entity could be in resolution without such terms and conditions having been triggered.

Cross-border Recognition of Resolution Actions

11. MAS seeks views on –

[5] Key Attributes at p. 71.

(a) the possibility of achieving a cooperative solution with foreign resolution authorities by giving effect to foreign resolution actions through a recognition process, subject to the considerations set out in paragraphs 7.8(a) to (c); and

(b) the scenarios where a foreign resolution action may not be in the interest of a local branch or subsidiary of a foreign financial institution, which MAS would need to take into consideration when deciding if it should recognise or support the foreign resolution action.

We support the proposal to establish a recognition process under which effect can be given to foreign resolution actions. It is indeed important for host authorities to cooperate with foreign resolution authorities in the context of resolution of cross-border CCPs.

Another important initiative for cross-border CCPs is the establishment of Crisis Management Groups (CMGs), which are considered in the FSB Key Attributes. CMGs will facilitate dialogue and discussion between the relevant supervisors, central banks and other public authorities. However, we believe that the decision making in respect of a particular entity or group should ultimately reside with a single resolution authority, which in our view should be the resolution authority of the jurisdiction in which the institution is established.

We agree that it is important for key domestic and cross-border counterparts to have information sharing arrangements agreed in advance, and ideally to have tested these as part of a crisis management exercise (if possible, with the participation of the relevant FMI).

In relation to 11(b), we would note that were resolution action not to be recognised in relation to a local branch or subsidiary of a foreign financial institution, a CCP may find itself in a position where its rules enabled or required it to place the local branch or subsidiary into default where it had not done so in respect of the resolved foreign financial institution itself.

Creditor Safeguards

12. MAS seeks views on the proposal to establish a creditor compensation framework applicable to creditors of banks, merchant banks, finance companies, insurers, capital market infrastructures, DPS operators and settlement institutions, and financial holding companies regulated by MAS.

We support the proposal in principle, subject to our comments under question 13.

13. MAS seeks views on the features of the proposed creditor compensation framework –

(a) the proposal to engage a qualified independent valuation agent to determine any creditor compensation payable and the criteria (if any) for the appointment of such a

valuation agent;

(b) the valuation principles that such a valuation agent should adopt;

(c) the appeal process on the compensation amount determined by the valuation agent; and

(d) other features that MAS should consider including in its creditor compensation framework.

We note that such a framework is not intended to cover recognised clearing houses, but nevertheless would like to state that a CCP's default arrangements are the first line of defence when dealing with the default of its members and this is reflected in the default waterfall provisions required of CCPs seeking approval or recognition. Therefore, any contributions that members or participants are obliged to make under default arrangements should be considered separately from the question of no creditor being worse off than in insolvency. To judge this test from where a CCP begins its default procedures would be premature and to do so would disincentive a member or participant from participating fully in the default management process. Instead, any such evaluation should be made at the time which the resolution authority intervenes to ensure that a CCP is prevented from otherwise going into insolvency.

Resolution Funding

14. MAS seeks views on the proposal for resolution funding arrangements to be used for – (i) costs incurred in the implementation of resolution measures; and (ii) any creditor compensation claims that may arise.

We do not believe that it would be appropriate for a CCP to be subject to a requirement that it contribute to any resolution fund. A CCP sits between parties to financial transactions and takes initial and variation margin as well as holding default fund resources to collateralise its exposures and mitigate its losses in the event a member defaults. The CCP therefore expects to meet any losses suffered if a member fails from resources provided by that member and it is only if these are insufficient that a CCP may (depending on the structure of its default resources) have to apply its own "skin in the game", as well as have recourse to the mutualised default fund provided by other members. As such, a CCP should not be adversely impacted by the failure of a financial institution, and would not therefore stand to benefit from an orderly resolution of that financial institution, in the same way as a party to a bilateral trade with that institution who will automatically suffer losses on default. In addition, a CCP may not be in a position to make significant ad hoc ex post recovery payments. Any of the defaulter's resources remaining after completion of the CCP's default process would be returned to the defaulter (and thus available to contribute towards the cost of resolution) but the CCP would not be entitled to apply other default fund resources to contribute to any fund.

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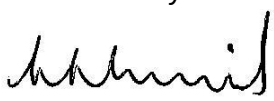
We hope that MAS finds this submission useful and we look forward to engaging further as the proposals are implemented. Please do not hesitate to contact me at rory.cunningham@lchclearnet.com or +61 2 8259 4111 regarding any questions raised by this letter or to discuss these comments in greater detail.

Yours faithfully



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