EUROCLEAR SA/NV
1 BOULEVARD DU ROI ALBERT II
1210 BRUSSELS, BELGIUM
RPM BRUSSELS NUMBER 0423 747 369
www.euroclear.com

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Report and Recommendations of the Cross-border Bank Resolution Group of the Basel Committee on Banking Supervision

Euroclear response

The Euroclear group is the world's leading provider of domestic and cross-border settlement and related services for bond, equity, fund and derivative transactions. User owned and user governed, the Euroclear group includes the International Central Securities Depositary (ICSD) Euroclear Bank, based in Brussels, as well as the national Central Securities Depositaries (CSDs) Euroclear Belgium, Euroclear Finland, Euroclear France, Euroclear Nederland, Euroclear Sweden and Euroclear UK & Ireland.

We are pleased to be given the opportunity to provide our view on the consultation issued by the Bank for International Settlements on the Report and Recommendations of the Cross-border Bank resolution group of the Basel Committee on Banking Supervision.

While we understand that these recommendations have not been drafted with (I)CSDs in mind, we would like to draw the attention to some of the, perhaps unintended, effects that the implementation of the recommendations could have on (I)CSDs and their business (and possibly on Central Counterparties (CCPs)). We have therefore focused our comments on those recommendations of specific relevance for (I)CSDs, either because they could apply directly to these (I)CSDs, or because the proposed measures could impact the (I)CSDs, and therefore the functioning of securities clearing and settlement systems, through customers which are subject to resolutions measures.

Scope

The report does not provide a definition of cross-border bank, but we understand from the discussions in the document that it should be understood in the broad sense to include any bank which either is active itself in multiple jurisdictions or is part of a group which, through its various group companies (financial institutions) is active in multiple jurisdictions. In some instances, it even seems that the recommendations could be applicable to "institutions providing systemically important functions" (point 92), whether operating across borders or not. Though adequate resolution mechanisms seem relevant indeed for institutions fulfilling such functions, we would welcome a more precise definition of "systemically important functions" if a functional applicability of the recommendations is foreseen.

Note that it may also be considered to apply relevant lessons learned at the national level, in order to enhance the overall harmonisation of resolution mechanisms and to ensure a level playing field between local and cross-border institutions.

While the document recognises that the recommendations are principally designed for cross-border banking institutions, we note that the application to other types of financial institutions active in multiple jurisdictions is also foreseen (cf. footnote 11). When considering whether and, if yes, how the recommendations should be applied to financial institutions other than banks, it is, however, important to ensure that such decisions are guided by the principle of proportionality. This will be important, for example, if the recommendations are applied to cross-border groups with non-bank subsidiaries, e.g. CSDs, which are only marginally exposed to credit risk or liquidity risk (see in particular our comments below under Recommendation 6).

<u>Recommendation 5 – Reduction of complexity</u>

Recommendation 5 includes an obligation on supervisors to get a clear view across borders on the separability of units or business lines of a cross border financial institution and the possibility of selling or spinning off such units or business lines in case of a crisis. It would be advisable to define business lines in line with the list identified and used under the Basel 2 framework.

We do understand the usefulness for authorities of having such information in case of a crisis, but the potential negative impact created by the mere existence of such information outside times of crisis should not be underestimated: spin-off and separation plans could by themselves generate speculations and be the source of instability in the financial markets. Given the highly commercially sensitive nature of this type of information, it will need to be handled by regulators with extreme caution.

We note that participation by a financial firm in payment and settlement systems is expressly mentioned in the list of issues for cooperation and planning between authorities. We fully subscribe to this recommendation, given the major role that some cross border banks play in the context of such systems, by channelling transactions from indirect participants to such systems, performing the role of settlement bank, as well as by establishing strong linkages between payment and settlement systems, as analysed in the CPSS report on *The Interdependencies of Payment and Settlement Systems.* Generally speaking, we would expect authorities to work in close cooperation with market infrastructures, such as securities settlement systems, in times of a crisis and believe that a clear view on the participation by the firm in domestic or foreign systems can only facilitate such cooperation.

Recommendation 6 – Planning in advance for orderly resolution

Recommendation 6 requires cross-border financial institutions to provide a plan, proportionate to the size and complexity of the institution, to preserve the firm as a going concern, promote the resiliency of key functions and facilitate the rapid resolution or wind-down should that prove necessary.

We support the principle of proportionality enshrined in this recommendation and, from the perspective of potentially applying the recommendation to CSDs, believe that regulators should take into account the fact that CSDs generally have no banking or investment relationship with their customers and therefore are not exposed to the credit or liquidity risks which may lead to an unexpected crisis with a resulting disorderly resolution scenario.

We fully endorse the need to have adequate contingency plans based on a going concern perspective, but, as noted under recommendation 5, we are concerned that the preparation of such plans for wind-down scenarios would face great difficulties. In addition to market rumours that may be caused by any leakages related to such plans, it may be extremely complex to cover all possible wind-down scenarios. For example, identifying entities that may continue operating on a stand-along basis can be done. However, in practice, it may be more appropriate to engineer the take-over of (part of) the firm by a competitor, as was done in many instances during the current crisis; preparing for such possible takeovers when firms are financially healthy cannot realistically be achieved.

Regarding the Management Information Systems (MIS) required under recommendation 6, we believe that a distinction should be made between quasi-static information, e.g. information on group structure, which changes only when mergers, acquisitions, opening of new subsidiaries or branches or reorganisations take place, and dynamic information, e.g. information on exposures, which changes daily and even intraday. It should not be required that such different types of information be available in a single database, but rather that it should be rapidly available when needed.

The recommendation currently mentions that the contingency plan should include information about payments and exchange systems on which the firm operates. In line with recommendation 5 and given the systemic importance of settlement in (I)CSDs, we believe it would be useful to include in this (non-exhaustive) list a reference to any securities settlement systems (and CCPs) in which the firm participates.

Recommendation 8 – Strengthening risk mitigation mechanisms

Recommendation 8 includes a suggestion to limit possibilities for the rehypothecation of collateral. Although it is well understood that the risks related to the rehypothecation of collateral should be appropriately mitigated, we believe that restrictions in this respect should take into account possible unintended consequences. For example, in the case of market infrastructures such as ICSDs, which provide intraday credit to their participants against collateral to facilitate the smooth settlement of transactions, such collateral may be reused to obtain short-term liquidity in the market. Constraining reuse may introduce a constraint on intraday credit provision which, in turn, may hamper the efficient settlement of transactions. To prevent such consequences from materialising, a limit on rehypothecation should not apply to very short-term re-use of client collateral, provided the client has wilfully accepted such arrangements.

We broadly support the call for more standardisation of derivative contracts wherever possible, as this is a key contributing factor to achieving greater transparency in the markets and to allow the implementation of more streamlined and automatic solutions for clearing and processing of derivatives transactions through market infrastructures.

While standardisation is a sensible strategy to pursue the target of risk reduction through maximisation of the portion of CCP eligible business, it needs to be recognised that full standardisation of all derivatives contracts is unlikely (or even not achievable) and that innovation and developments in financial markets are likely to continue to result in non-standard tailored structures. While these may not be eligible for CCP-clearing, this does not imply that the related counterparty risks cannot be successfully mitigated through bilateral clearing arrangements or other mechanisms.

Euroclear believes that existing or new market infrastructure solutions supporting bilateral clearing can achieve very similar risk mitigation effects in OTC markets as CCP clearing. They can provide for industry/market infrastructure solutions in terms of aligning positions and exposures bilaterally and agreeing on margin calls and integrate this with an efficient same-day collateral process to cover the full exposure.

Recommendation 9 – Transfer of contractual relationships

Pursuant to recommendation 9, authorities should be given the power to temporarily delay immediate operation of contractual termination clauses so as to allow authorities to transfer all or part of the activity of an entity in financial difficulty to another institution while preserving financial stability in the market. The recommendation focuses, in our view rightly, on the exercise by counterparties to the failing entity of termination, netting and similar rights which are advanced in time as a result of the entity's financial difficulty, opening of insolvency procedures or application of resolution measures (through legal constructions such as acceleration, cross-default, definitions of default events etc).

Although the recommendation generally does seem to contemplate only the suspension of "early" termination rights, the drafting of, in particular, the opening sentence is ambiguous and leaves some uncertainty about the scope. We urge the Basel Committee to clarify this point before the recommendations are issued. For example, it might be helpful to add wording such as "representing early termination rights" after the words "termination clauses" in the first sentence of the recommendation.

Indeed, we are concerned that in case the recommendation were to be given a broader application beyond "early" rights, this could prevent counterparties from realising their collateral for debts which are due and payable under the normal operation of an agreement, thereby creating a liquidity risk for the counterparty. In cases where the counterparty is a market infrastructure (at either clearing or settlement level), or, for example, a settlement bank in such infrastructure, we do not believe that such a transfer of risk would be acceptable as it would go counter to the stated objective of reducing risk contagion and ensuring overall financial stability.

Contacts

For further information, please contact:

- Paul Symons, Head of Public Affairs (Paul.Symons@euroclear.com) or +44 (0)207 7849 0034)

- Marianne Sandel, Legal Division (Marianne.Sandel@euroclear.com) or +32 (0)2 326.11.21)

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