WFE Response to the Bank of England on Central Counterparty Resolution Execution and Resolvability Outcomes

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Response

The World Federation of Exchanges (WFE) welcomes the opportunity to respond to the recent discussion paper from the Bank of England (the Bank) on central counterparty (CCP) resolution execution and resolvability.

The WFE and its members support the Bank's objective of ensuring that CCP resolution arrangements are credible, operationally feasible, and capable of preserving continuity of critical clearing services in the highly remote event of CCP resolution. The WFE emphasises that CCP recovery should be permitted and encouraged to run its course wherever recovery remains viable. Resolution should only be triggered where recovery measures have been exhausted, or where continued recovery would clearly threaten broader market stability.

Given the extreme remoteness of CCP resolution and the demonstrated resilience of existing CCP recovery and resilience frameworks, any additional requirements should be supported by clear evidence of necessity, remain proportionate to the risks identified, and avoid introducing operational burdens or incentive distortions that could undermine recovery effectiveness, weaken participant engagement, or disincentivise central clearing.

The WFE strongly supports a principles-based, internationally coordinated approach to CCP resolvability that preserves operational flexibility, builds wherever possible on existing regulator-approved CCP recovery arrangements, and avoids unnecessary divergence across jurisdictions.

<u>Resolution powers and the creditor hierarchy in an NDL resolution scenario</u>

1. Has the Bank correctly identified and understood the challenges associated with calculating the allocation of losses in an NDL resolution, as described in the section above?

We recognise the Bank's objective of reducing NCWO risk and improving operational certainty in an NDL resolution. However, requiring CCPs to subordinate clearing members' default fund contributions for these purposes could have significant legal, economic and incentive effects. The Bank should instead consider less structural alternatives such as enhanced modelling, valuation templates, and resolution simulation exercises. The WFE encourages the Bank to exhaust operational solutions before considering legal restructuring of creditor hierarchies.

2. Are there any potential options in addition to those identified by the Bank above?

The WFE considers that resolution planning should build on, and leverage, the extensive work already undertaken by CCPs as part of their recovery planning and ongoing risk management. While operational readiness for resolution is important, this work should be appropriately balanced against the need to maintain focus and resources on CCPs' core risk management and resilience, which remain the first line of defence against the need for resolution. Potential additional options include:

- Enhanced ex-ante scenario testing involving CCPs, clearing members and relevant authorities;
- Operational playbooks for accelerated resolution-time valuation support;
- Practical simulation exercises to test resolution execution capabilities.

The WFE would encourage the Bank to prioritise operational preparedness and analytical enhancement, building where possible on existing CCP recovery planning and risk management frameworks, before considering structural interventions.

3. What factors should the Bank take into account when considering the potential benefits, risks and costs of such options?

The Bank should consider:

- Effects on participant incentives
- Operational feasibility under compressed timelines
- Legal certainty and enforceability
- Proportionality of implementation costs, and

- Risks of introducing unnecessary complexity that could hinder effective resolution execution

4. Would any of the potential options carry material risk of unintended consequences?

Yes. Structural changes to creditor hierarchies, including contractual subordination of default fund contributions, could introduce legal uncertainty, alter clearing member incentives, and create divergence from established international frameworks. Such changes could also create operational complexity in cross-border insolvency and resolution contexts.

Returning value to CCP creditors in an NDL resolution scenario

5. Are there any other potential options to expose CCP equity to loss and to return value to creditors in addition to the two broad options identified by the Bank above?

The WFE is not persuaded that sufficient evidence has been presented to justify ex-ante structural mechanisms beyond the Bank's existing resolution powers. The priority should remain ensuring effective use of existing recovery tools and statutory resolution powers.

6. What factors should the Bank include when considering the potential benefits, risks and costs of such options?

The Bank should consider:

- Operational continuity
- Governance practicality
- Incentive alignment
- Costs to clearing users
- Compatibility with existing ownership and group structures
- International consistency
- Preservation of incentives for clearing member participation in recovery processes

7. Would any of the potential options carry material risk of unintended consequences?

Yes. The WFE does not support the suggestion that CCPs could ensure that they do not have any dependencies on systems or staff provided by a parent group. As pointed out in the paper, this would result in duplicated technical infrastructure and staffing, creating substantial costs that would reduce the attractiveness of using central clearing services. This is directly opposed to the G20 mandate to incentivise the use of central clearing.

The WFE also cautions against a prescriptive approach to ownership transfer or other structural measures. While such tools may form part of some existing CCP resolution regimes, their use should take appropriate account of the applicable resolution framework and circumstances of the individual CCP. If applied without sufficient flexibility, such measures may create governance fragmentation, operational disruption and legal complexity. Furthermore, the WFE warns that profit-sharing arrangements may also introduce valuation disputes, governance complexity, and uncertainty regarding long-term shareholder incentives. More broadly, care should be taken to ensure that any measures intended to improve resolution outcomes do not undermine incentives for clearing participants to engage actively in the default management process and support recovery efforts.

Considerations in the execution of a statutory partial tear up

8. Might the Bank adopting a pro-rata approach to a tear-up present any risks or potential unintended consequences? What factors should the Bank consider when assessing whether, and if so how, to utilise any flexibility in the allocation or scoping of a statutory tear up in resolution?

A pro-rata approach to resolution tear-ups could produce suboptimal outcomes under stressed market conditions. The Bank should consider:

- Prevailing market liquidity
- Position concentration
- Hedging disruption
- Potential contagion effects
- Operational speed
- Product and market structure considerations

9. Should any of these factors, or subset of factors, be prioritised over others by the Bank in performing our ex-ante or resolution scenario specific assessments?

Yes. The primary objective should be preservation of financial stability and continuity of critical clearing services. Secondary considerations should include minimising contagion and preserving predictability where possible.

10. Could the Bank's potential consideration of different options with regard to the scoping or allocation of a partial tear up in resolution carry material risk of unintended consequences?

Yes. The WFE advise against highly prescriptive ex-ante specification of tear-up sequencing or resolution trigger mechanics. Given the inherently idiosyncratic nature of extreme resolution scenarios, sufficient flexibility should be retained to determine the most appropriate course of action based on prevailing circumstances. Resolution arrangements should provide guiding principles without constraining the ability to respond appropriately to scenario-specific conditions.

In particular, arrangements should not encourage premature intervention or result in resolution measures being applied while CCP recovery remains viable. Consistent with the WFE's overarching position, CCP recovery should be permitted and encouraged to run its course, with resolution measures deployed only where recovery has been exhausted or continued recovery would clearly threaten broader market stability.

CCP resolvability

11. Has the Bank identified an appropriate set of 'resolvability outcomes' for CCPs? Are the topics set out in the high-level descriptions of these outcomes comprehensive, reasonable and proportionate?

The WFE supports the Bank's decision not to replicate a bank-style resolvability assessment framework for CCPs. CCPs are fundamentally distinct from banks in their risk profile, operational structure, governance arrangements, and rulebook-based loss allocation processes. Applying bank-style public assessment or disclosure frameworks to CCPs would risk imposing disproportionate burden without commensurate resilience benefit. Reliance on existing CCP operational capabilities and established recovery arrangements is appropriate.

12. Are there any further issues the Bank should consider when assessing the resolvability of a UK CCP?

The Bank should consider whether proposed arrangements preserve the primacy of CCP rulebook-based recovery processes.

The WFE considers it important that resolvability arrangements build, wherever possible, on CCPs' existing rulebook-based recovery and loss-allocation frameworks rather than creating parallel operational structures that could undermine certainty or weaken established participant incentives.

Conclusion

The WFE supports efforts to maintain CCP resolution preparedness. However, given the absence of practical precedent for CCP insolvency, the extreme remoteness of CCP resolution scenarios, and the demonstrated resilience of existing recovery and resilience frameworks, any structural changes should be supported by compelling evidence that existing recovery and resolution arrangements are insufficient. Nothing in the resolution framework should undermine incentives for effective recovery or weaken reliance on pre-existing, regulator-approved CCP risk management and loss allocation arrangements.

The WFE welcomes continued engagement as the Bank develops its policy framework.

Background

Established in 1961, the World Federation of Exchanges (WFE) is the global industry association for exchanges and central counterparties (CCPs). Headquartered in London, it represents over 250 market infrastructure providers, including standalone CCPs that are not part of exchange groups. Of our members, 37% are in Asia-Pacific, 43% in EMEA, and 20% in the Americas.

The WFE's 87 member CCPs and clearing services collectively ensure that risk takers post some $1.1 trillion (equivalent) of resources to back their positions, in the form of initial margin and default fund requirements. WFE exchanges, together with other exchanges feeding into our database, are home to over 49,000 listed companies, and the market capitalisation of these entities is over $116.58 trillion; around $155 trillion (EOB) in trading annually passes through WFE members (at end 2024).

The WFE is the definitive source for exchange-traded statistics and publishes over 350 market data indicators. Its free statistics database stretches back 49 years and provides information and insight into developments on global exchanges. The WFE works with standard-setters, policy makers, regulators, and government organisations around the world to support and promote the development of fair, transparent, stable and efficient markets. The WFE shares regulatory authorities' goals of ensuring the safety and soundness of the global financial system.

With extensive experience of developing and enforcing high standards of conduct, the WFE and its members support an orderly, secure, fair, and transparent environment for investors; for companies that raise capital; and for all who deal with financial risk. We seek outcomes that maximise the common good, consumer confidence and economic growth. And we engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in a globally integrated financial system.

If you have any further questions, or wish to follow-up on our contribution, the WFE remains at your disposal. Please contact:

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