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## **CCP R&R (RECOVERY AND RESOLUTION FOR CCPs)**

Updated in October 2023

The 2008 crisis has shown that the default of a participant if it is a big player may lead to severe systemic disruptions. During the G20 (2011 Cannes), the Financial Stability Board (FSB) has been asked to work on measures that could be undertaken to handle the resolution process of a financial institution. In November 2011, the G20 endorsed the « Key Attributes of Effective Resolution Regimes for Financial Institutions » issued by the FSB.

Some of these entities considered as systemic like Financial Market Infrastructures (Central Counterparties -CCP-, Central Depositories -CSD-, Settlement Systems -SSS-, Payment Systems or Trade Repositories) play an essential role in the global economy so that their default could not end up just through a bankruptcy/insolvency process since those regimes do not have the preservation of financial stability as an objective but are rather focused on the creditors. For such entities, one needs to have in place a legislation which allows them to maintain their critical services despite everything; this is the purpose of the Recovery & Resolution plans.

If the recovery phase consists for the entity to take measures using dedicated tools, when the entity is under a resolution process (the step further) it is taken over by the resolution authority (including national competent authorities). Such an authority may be allowed to use extraordinary measures (even outside the common law). Recovery and of course resolution are linked to period in the life of an entity where it cannot anymore face consequences of major difficulties even through a Business Continuity Plan. At this stage, most of the time financial losses are involved that must be covered to let the entity maintain its services. The aim of most of the recovery/resolution tools is to allocate those losses either to participants or to shareholders rather than exposing taxpayers to loss.

The topic of recovery and resolution is addressed at different levels. While the European Commission (EC) works on a regulation focused on CCPs, the FSB (on resolution) and CPMI/IOSCO<sup>1</sup> (on recovery) have issued recommendations not always limited to CCPs. Practically the European CCP Recovery & Resolution shall apply, should the measures contained in EMIR prove to be insufficient.

The CCP Recovery & Resolution regulation has three main objectives:

- 1. SAFEGUARDING OF THE FINANCIAL STABILITY**
- 2. CONTINUITY OF CRITICAL FUNCTIONS**
- 3. PROTECTION OF THE TAXPAYERS**

In addition with **ANTICIPATION** to help preserve the financial stability.

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<sup>1</sup> CPMI is the Committee on Payments and Market Infrastructures within the Bank for International Settlements (BIS). IOSCO is the International Organisation of Securities Commissions bringing together the world's securities regulators.

## 1. Overview

### a. Key aspects of the Regulation

- Scope / proportionality**

The regulation applies to all CCPs authorised in accordance with EMIR. However requirements may vary depending on their systemic relevance (proportionality).

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- Resolution Actors**

The text institutes Resolution Authorities and Competent Ministry designated by each Member State. It also requires ESMA to create a Resolution Committee which shall promote the development and coordination of resolution plans and develop methods for the resolution of failing CCPs.

**FINANCIAL STABILITY**

#### RESOLUTION AUTHORITIES

They are empowered to handle the resolution process; they shall be national central banks, competent ministries, public administrative authorities or other authorities entrusted with public administrative powers. The resolution authority shall establish, manage and chair a resolution college to carry out the tasks in relation to the resolution of a CCP and ensure cooperation and coordination with third country resolution authorities.

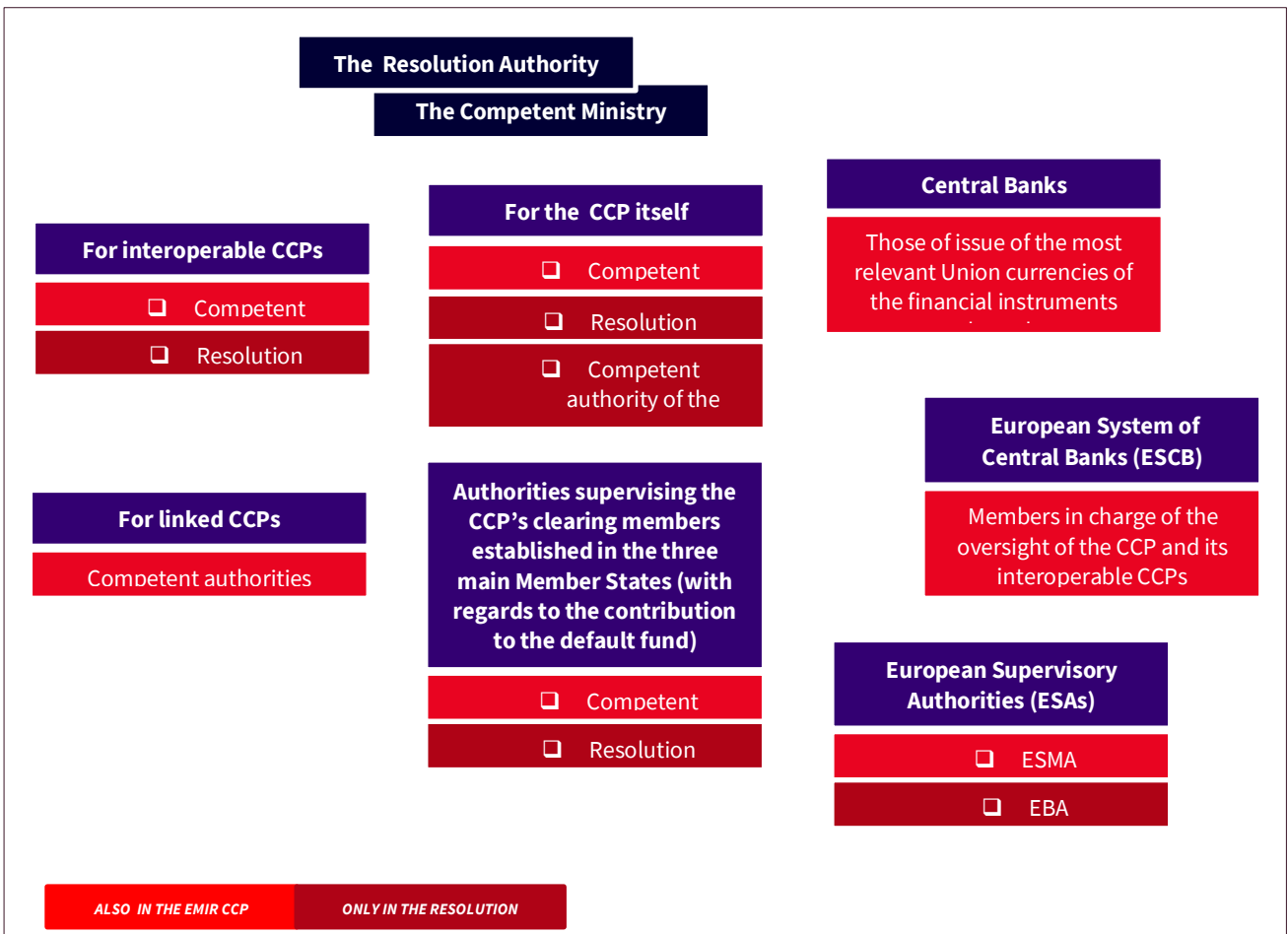
#### COMPETENT MINISTRIES

If the competent ministry is not the resolution authority then the latter should keep the former informed of the decisions taken. The role of the competent ministry is related to the use as a last resort of government stabilisation tools.

#### RESOLUTION COLLEGE

The resolution college is made of different members among which several are also members of the CCP college instituted by EMIR (see below).

#### THE RESOLUTION COLLEGE



It should be noted that the entry into force of EMIR 2.2 (dedicated to the supervision of EU and non EU CCPs) brings changes on the composition of the CCP colleges and extend the principle of CCP college to non EU CCPs. Moreover EMIR 2.2 institutes a CCP Supervisory Committee covering all CCPs. This will be an internal and permanent ESMA committee.

- **Recovery and Resolution Plans**

A plan is required both for the recovery phase and the resolution phase. It must be prepared by the CCP (recovery) or by the resolution authority (resolution). This shall be done ex-ante. In addition, the plans should be regularly reviewed and updated (at least annually).

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#### RECOVERY PLAN

The recovery plan shall provide for the measures to be taken by the CCP to restore its financial position and also indicators identifying the circumstances under which the measures shall be taken. However, the plan shall ensure that clearing members do not have unlimited exposures towards the CCP (an annex of the regulation details the requirements applied to the plan).

The plan shall be assessed by the board of the CCP considering the advice of the Risk committee instituted by EMIR and composed of representatives of its clearing members, independent members of the board and representatives of its clients. In addition, the plan shall be submitted to the CCP's competent authority for approval. The CCP's college as well as the CCP's resolution are also involved in the process of assessment.

The plan shall cover the case of the default of clearing members ("default events") but also the case of other risks and losses ("non-default events"). It shall be comprehensive, effective, transparent and measurable for those potentially impacted by it. In addition, clearing members are required to inform their clients how they would transmit any losses or costs arising from the exercise of recovery tools by the CCP to them.

#### RESOLUTION PLAN

The resolution plan shall provide for the resolution actions to be taken by the resolution authority where the CCP meets the conditions for resolution (where the recovery plan appeared to be not sufficient to restore the situation). The CCP's competent authority and its resolution college are involved in the definition of the plan. If drawn up by the resolution authority, it shall also be jointly agreed by the authorities of the resolution college.

The resolution plan shall describe how a CCP would be restructured and its critical functions kept alive should its failure be due to a "default event" or a "non-default event".

- **Resolvability of the CCP**

As stated in the regulation, "a CCP shall be deemed resolvable where the resolution authority considers it feasible and credible to either liquidate it under normal insolvency proceedings or to resolve it using the resolution tools and exercising the resolution powers while ensuring the continuity of the CCP's critical functions and avoiding to the maximum extent possible any significant adverse effect on the financial system". The assessment of the resolvability shall be done without assuming "an extraordinary public financial support or a central bank emergency liquidity assistance or a central bank liquidity assistance provided under non-standard collateralisation, tenor and interest rate terms" (an annex of this regulation lists the matters the resolution authority shall consider when assessing the resolvability of a CCP).

Should the assessment show substantive impediments to the resolvability then the CCP will be required to propose measures to address or remove these impediments.

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- **Entry into recovery / resolution**

#### THE EMIR DEFAULT WATERFALL

EMIR details the rules a CCP shall apply in case of a clearing member defaults and how the CCP can use the margins and the contributions to the default fund to cover losses:



1. margins posted by the defaulting clearing member
2. the default fund contribution of the defaulting member
3. the CCP's dedicated own resources
4. the default fund contributions of non-defaulting clearing members

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A CCP shall not use the margins posted by non-defaulting clearing members to cover the losses resulting from the default of another clearing member.

One should note that where the EMIR's default waterfall process applies only in the case of a "default event", the recovery as well as the resolution process shall cover also a "non-default event".

#### RECOVERY PHASE

The recovery phase starts when the CCP's default management resources or other requirements under EMIR are not sufficient to overcome any form of distress the CCP faces. However, the regulation doesn't fix the precise circumstances in which the plan should be triggered. CCPs are required to develop suitable indicators informing clearing members and authorities for when this would occur.

#### RESOLUTION PHASE

As stated in the regulation, "a CCP should be placed in resolution when it is failing or likely to fail, when no private sector alternative can avert failure, and when its failure would jeopardise the public interest and financial stability. In addition, in line with the guidance of the Financial Stability Board Key Attributes for Effective Resolution Regimes, a CCP could be placed into resolution even if not these conditions are met, where the application of further recovery measures by the CCP could prevent its failure but could compromise financial stability in the process. Except for very specific circumstances, the CCP should also be failing or likely to fail if it requires extraordinary public financial support".

- **Resolution tools**

Resolution aims to maintain the critical functions of the CCP while allowing the remaining parts to be wound down in an orderly manner. There is no dedicated tool for a dedicated situation. It is more about a box of tools that can be used separately or in conjunction, namely the sale of the entire CCP or of its critical functions to a viable competitor, the creation of a publicly controlled bridge CCP and the allocation of losses and positions among the remaining clearing members. The latter could take different forms.

Examples of tools are auctions of the defaulters' positions, a partial or full tear-up of contracts, further haircuts of outgoing variation margin payments, the exercise of any outstanding cash calls set out in recovery plans or of a cash call reserved specifically for the resolution authority in the CCP's internal (operating) rules, and a write-down of capital and debt instruments issued by the CCP or other unsecured liabilities and a conversion of any debt instruments or other unsecured liabilities into shares (some of them may also be part of the recovery plan built by the CCP). However the regulation leaves room for other options to be used by the resolution authority.

Finally and as a last resort and under certain conditions, the resolution authority may use government stabilisation tools such as public financial support provided for the recapitalisation of the CCP in exchange of instrument of ownership or temporary public ownership.

**FINANCIAL STABILITY**

**CRITICAL FUNCTIONS**

**TAXPAYERS**

- **Early intervention**

The CCP's competent authority (designated in accordance with EMIR) is granted specific powers to intervene in the operations of a CCP if the CCP's failure is about to happen. For example, the CCP can be required to implement one or more of the measures set out in the recovery plan. Early interventions may also be the removal of members of the board, changes in the CCP's business strategy or its legal/operational structure, ...

**ANTICIPATION**

## b. Other aspects

- **Safeguards**

If one of the objective is to avoid any impact on taxpayers, the regulation requires the resolution authority to ensure that shareholders, creditors and clearing members do not incur greater losses than they would have incurred had the resolution authority not take resolution action (in case of a "default event") or had the CCP been wound up under normal insolvency proceedings (in case of a "non-default event"). This principle is known as the "No Creditor Worse Off" principle.

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A valuation shall be undertaken to assess the compliance with the above principle. Should the assessment show that the resolution action wasn't fully compliant then shareholder(s), creditor(s) or clearing member(s) are entitled to the payment of the difference between the incurred losses and the assessed losses.

The regulation includes several additional safeguards with regards to financial collateral, set off, netting agreements, security arrangements, structured finance arrangements and covered bonds.

- **Clearing Obligation**

This regulation modifies EMIR, the regulation on OTC derivatives, CCPs and Trade Repositories, by introducing a temporary suspension of the clearing obligation (for more information please refer to our EMIR documentation) in case of a CCP's resolution.

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### **c. Progress update and way forward:**

- **At the European level**

The EC's proposal (issued on the 28 November 2016) has been submitted to the European Parliament (EP) and the European Council. On the 23rd of June 2020, the Parliament and the Council of the EU have reached a political agreement on the proposed Regulation on the recovery and resolution of central counterparties (CCPs).

As a remainder, main points of the Political Agreement:

- A requirement for CCPs to draw up plans for addressing "default events", when one or more clearing members fail to honour their financial obligations and "non-default events", such as a business failure incurring losses.
- An ex-ante (and ex-post) notification by the resolution authorities to the college of the resolution about actions they intend to take and whether the resolution action deviates from the resolution plan.
- A prohibition or restriction of dividends and bonuses where a default event has been caused by mismanagement.
- An additional, pre-funded "second skin in the game" to be used by the CCP prior to the application by the CCP of any cash call or variation margins gains haircutting (VMGH) in recovery.
- Participation of clients in auctions under certain circumstances and conditions
- Resolution cash calls could be used also in case of non-default events
- Several conditions have been added for the use of the government stabilisation tools in the form of equity support and temporary public ownership
- A requirement that a CCP should compensate non-defaulting clearing members and clients through cash payments or ownership in future profits where it has reduced payments to these members and clients in a non-default scenario
- A modification of EMIR to allow the suspension of the clearing and of the trading obligations in cases of resolution

On the 22 of January 2021 the regulation was published in the EU Official Journal and entered into force 20 days after (ie the 12th of February 2021). The regulation 2021/23 will enter into application from 12 August 2022, with the exception of certain provisions detailed in Article 97:

- Certain provisions in Articles 9 and 10 concerning recovery plans, which will apply from 12 February 2022.
- Certain provisions in Articles 9 and 20 concerning the use of CCP's prefunded dedicated own resources and the compensation of non-defaulting clearing members, which will apply from 12 February 2023
- Relating to the suspension of the MIFIR DTO (Derivatives Trading Obligation): as of July 2020
- Some changes in EMIR (suspension of the clearing obligation, references to index, temporary restrictions): as of 11 February 2021.

Following the consultations launched in 2021 and 2022, ESMA has issued guidelines and draft final reports:

- Guidelines on the application of the circumstances under which a CCP is deemed to be failing or likely to fail (article 22(6))
- Guidelines for the methodology to value each contract prior to termination (article 29(7))

- Guidelines on the types and content of the provisions of Cooperation arrangements (Article 79 of CCPRRR)
- Guidelines on the assessment of resolvability (Article 15(5) of CCPRRR)
- Draft RTS on safeguards for clients and indirect clients (Article 63(2))
- Draft RTS on resolution colleges (Article 4(7))
- Draft RTS on the content of CCP resolution plans (Article 12(9))
- Draft RTS on the requirements for independent valuers, the methodology for assessing the value of the assets and liabilities of a CCP, the separation of the valuations, the buffer for additional losses to be included in provisional valuations and the methodology for carrying out the valuation for the purpose of the 'no creditor worse off' principle (Articles 25(6), 26(4), 61(5))
- Draft RTS specifying the conditions for recompense (order in which CCPs must pay recompense to non-defaulting clearing members, the maximum number of years during which those CCPs are to use a share of their annual profits for such payments to possessors of instruments recognising a claim on their future profits and the maximum share of those profits that is to be used for those payments) (article 20(2))
- Draft RTS on methodology for calculation and maintenance of the additional amount of pre-funded dedicated own resources (C(2022) 8434) (Article 9(15))
- Draft RTS specifying factors considered by the competent authority and the supervisory college when assessing CCP recovery plans (Article 10(12))

The draft RTS should be adopted by the EC and then follow the non objection process.

On the 03/03/2023, the delegated acts 2023/450 (in relation to article 20(2)) and 2023/451 (in relation to article 10(12)) have been published in the EU OJ and will enter into force on the 23<sup>rd</sup> of March 2023

In August 2023 two delegated regulations have been published in the EU OJ:

- **2023/1616:** on the requirements for independent valuers, the methodology for assessing the value of the assets and liabilities of a CCP, the separation of the valuations, the buffer for additional losses to be included in provisional valuations and the methodology for carrying out the valuation for the purpose of the 'no creditor worse off' principle (Articles 25(6), 26(4), 61(5))
- **2023/1615:** regulatory technical standards specifying the conditions under which compensation, cash equivalent of such compensation or any proceeds that are due pursuant to Article 63(1) of that Regulation are to be passed on to clients and indirect clients and the conditions under which passing on is to be considered proportionate

**NEW!**

Expected for 2023 (as indicated in the ESMA's Annual Work Programme):

- Guidelines on Template written agreement for resolution colleges
- Guidelines Template Summary Reoslution Plans
- A draft RTS issued by ESMA on business reorganisation plans (Article 37(4) and Article 38(4)) following its consultation launched Q4 2022

- **At the international level**

FSB & CPMI/IOSCO

In November 2020, the FSB and CPMI/IOSCO decided to collaborate on and conduct further work on CCP financial resources in recovery and resolution. Such work would consider the need for, and develop as appropriate, international policy on the use, composition and amount of financial resources in recovery and resolution to further strengthen the resilience and resolvability of CCPs in default and non-default loss scenarios. In March 2022, the two bodies issued a report presenting the first findings.

Conclusions and next steps (extracts from the report):

*Based on the results and challenges of the evidence gathering and analysis undertaken, there is merit to continuing work on CCP financial resources for recovery and resolution. While all the sampled CCPs would have had sufficient prefunded and recovery resources and tools to cover losses in the applied CCP-specific default loss scenarios, the analysis was subject to a number of limitations and assumptions that suggest that the results are to be interpreted cautiously.*

*Moreover, one of the non-default loss scenarios applied would have resulted in the need to use resolution powers in the majority of the CCPs. Even though at the level of individual bank clearing members the analysis identified only limited impacts on their liquidity and solvency from the use of cash calls and VMGH by an individual CCP, it would be beneficial to enhance as much as possible the understanding of the potential complex system-wide effects of the use of recovery and resolution tools.*

Informed by this evidence gathering and analysis, the FSB has decided to continue to review the sufficiency of the existing toolkit for CCP resolution, focusing in particular on non-default loss scenarios.

Further work will consider the need for, and costs and benefits (including effectiveness and impact on incentives) of potential alternative financial resources and tools for CCP resolution. This further work, to be undertaken in cooperation with CPMI-IOSCO, will be initiated in Q2/2022.

In addition, CPMI-IOSCO has work underway on CCP non-default losses in resilience and recovery.

It is also important that CCPs and resolution authorities have in place a set of recovery and resolution tools, respectively, that is consistent with the existing international standards and guidance. CPMI-IOSCO remain committed to full, timely and consistent implementation of the PFMI standards on CCP financial resources and tools for resilience and recovery, supplemented by the CPMI-IOSCO guidance on FMI recovery. The FSB will continue to conduct and enhance the monitoring of the implementation of the FSB guidance on CCP resolution.

## 2. Reference text(s)

### EU

- [European Parliament – Presentation](#)
- [European Parliament - Procedure File](#)
- [Level 1 EC draft proposal and annex](#)
- [Level 1 EP adopted proposal](#)
- [Level 1 Council draft proposal](#)
- [Official text 2021/23](#)
- [ESMA's opinion on the EC proposal](#)
- [EP think Tank](#)
- [2023/450](#)
- [2023/451](#)

### FSB

- [Consultation on Application of the Key Attributes of Effective Regimes to Non-Bank Financial institutions \(August 2013\)](#)
- [Key Attributes of Effective Resolution regimes for Financial Institutions \(new version – October 2014\)](#)
- [Consultation on Guidance on Central Counterparty Resolution and Resolution Planning \(February 2017\)](#)
- [Answers on the Consultation on Guidance on Central Counterparty resolution and Resolution Planning \(July 2017\)](#)
- [FSB Guidances November 2020](#)
- [Joint work \(FSB & CPMI/IOSCO\) March 2022](#)

### CPMI / IOSCO

- [Principles for financial market infrastructures \(April 2012\)](#)
- [Recovery and resolution of FMI - consultative report \(July 2012\)](#)
- [Recovery of FMI - consultative report \(August 2013\)](#)
- [Recovery of financial market infrastructures \(October 2014\)](#)
- [Resilience of central counterparties \(CCPs\): Further guidance on the PFMI \(July 2017\)](#)
- [Recovery of FMI \(updated version – July 2017\)](#)