



R&R (RECOVERY & RESOLUTION FOR CCPs)

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 (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.

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.

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, **ANTICIPATION** to help preserve the financial stability.

1. Overview

- 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).

FINANCIAL STABILITY

- 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.

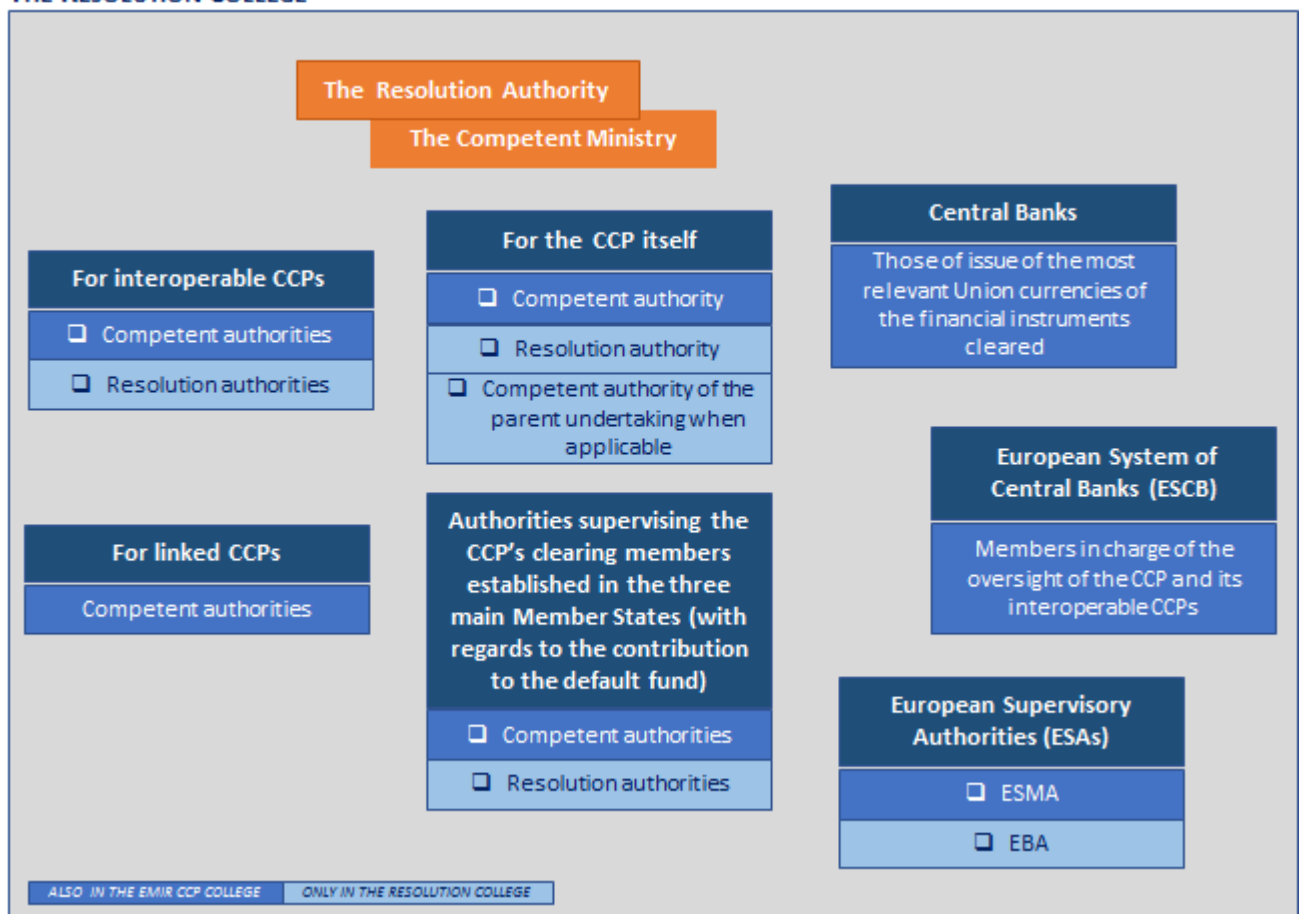
COMPETENT MINISTRIES

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



- Recovery and Resolution Plans

ANTICIPATION

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).

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 it failure be due to a "default event" or a "non-default event".

- Resolvability of the CCP

FINANCIAL STABILITY

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.

- Entry into recovery / resolution

FINANCIAL STABILITY

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:

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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

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’s 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.

TAXPAYERS’ PROTECTION
CRITICAL FUNCTIONS
FINANCIAL STABILITY

- 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

- **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.

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.

FINANCIAL STABILITY

- 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.

FINANCIAL STABILITY

- **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. They both have issued their amended version. The EP has adopted its version on the 27th of March 2019.

To be noted, the 3 EU Institutions (EP, Council and EC) have committed to agree each year on a number of priority proposals, to which they want to ensure substantial progress. These priority proposals are included in the so-called Joint Declaration on the EU's legislative priorities. The Recovery and Resolution for CCPs proposal was in the 2017 list as well as in the 2018 list.

Some delay may appear since there are divergences of opinion at the European level about the powers ESMA may benefit of. Moreover the EU may prefer to wait for some international recommendations to be issued.

PROPOSAL OF THE EUROPEAN PARLIAMENT (EP)

Among the different Parliament's amendments

- Recovery plan: where the EC proposal focuses on the resolution plan rather than on the recovery one, the EP deeply details what the recovery plan shall do / is allowed to do; what it shall contain. In addition, the EP requests where feasible present separately the case of a default event and the case of a non-default event. Moreover, the EP gives different means to allocate losses depending on the case
- Resolution college: the EP proposes to include competent authorities in charge of the supervision of Other Systematically Important Institutions (O-SII)
- Recovery phase in case of a non-default event: EP to require CCP to recompense, under certain conditions, participants (clearing members and their clients) for their loss
- Sanctions: the EP institutes administrative penalties and other administrative measures including in certain cases a public statement against CCPs, clearing members and parent undertakings

PROPOSAL OF THE EUROPEAN COUNCIL

- Recovery plan: shall distinguish between a default event and a non-default event.
- Recovery phase: full allocation of losses for default events but adequate absorbency for non-default ones.
- Sanctions: The Council institutes administrative penalties and other administrative measures including in certain cases a public statement against CCPs, clearing members and parent undertakings

ESMA

ESMA which has issued in April 2017 its comments on the European Commission's proposal intended according to its workplan for 2018 to consult on different topics in relation with the EC's proposal (for future RTS):

- Content of the resolution plan
- Valuation of the assets, liabilities, rights and obligations of the CCP
- Written arrangements and procedures for the functioning of the resolution college
- Valuation of the No Credit Worse Off

Also in 2018, ESMA announced it will continue its preparatory work on guidelines (one on conditions for entry into resolution of CCPs, one on the content of cross-border cooperation arrangements for CCP resolution)

At the international level

FSB

Dietrich Domanski (Secretary General of the FSB) has announced at the Eurofi meeting (26/04/2018) that the FSB will deliver to the Buenos Aires G20 summit (scheduled on the 30 November – 1st December 2018) an assessment to determine whether there is a need for additional guidance on financial resources to support CCP's resolution and on the treatment of CCP equity in resolution. The FSB has launched a consultation on financial resources to support CCP resolution and the treatment of equity in CCP resolution (answers was expected for the 1st of February 2019).

To be reminded the FSB issued guidance on CCP Resolution and Resolution Planning in July 2017.

CPMI/IOSCO

On its side CPMI-IOSCO has issued two guidance documents also in July 2017: a revised version of the "Recovery of financial market infrastructures" (dated October 2014) and its final report "Resilience of central counterparties (CCPs): Further guidance on the PFMI".

These 3 publications completed the key substantive priorities set out in the *Joint CCP Workplan for 2015*.

2. Reference law(s) and effective date



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](#)

[ESMA's opinion on the EC proposal](#)

[EP think Tank](#)

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 \(July 2017\)](#)

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 PFM (July 2017)

[Recovery of FMI \(updated version – July 2017\)](#)

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