

CCPs Recovery and Resolution Legislative Tracker

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The Simmons & Simmons CCPs Recovery and Resolution Legislative Tracker

This Legislative Tracker provides you with an update on the Central Counterparties (CCPs) Recovery and Resolution Regulation, setting out:

- a high level background to and summary of the main aims of the Regulation
- a table of the key dates in the process of agreeing the Level 1 text (with links to the relevant documents), and
- a table setting out what is currently known about the consultation process for Level 2/Level 3 measures.

Background

CCPs are financial market infrastructures regulated under the European Market Infrastructure Regulation (EMIR). They deal in financial transactions in various asset classes and provide services both to their clearing members, with whom they have a direct contractual link, and to their clearing members' clients. In this way, CCPs link multiple financial entities and concentrate significant amounts of their exposure to diverse risks present in financial markets. Given their central and growing importance in financial markets, all CCPs in the EU are considered to be systemic and their failure, although considered unlikely, could potentially be highly disruptive for financial system as well as negatively impact the wider economy.

The European Commission's *Proposal* for a Regulation on a framework for the recovery and resolution of CCPs (the Proposed Regulation) adopted on 28 November 2016, aims to address the situations in which CCPs fail or face severe distress. The Proposed Regulation is intended to implement within the EU the approach for the recovery and resolution of systemically relevant financial institutions, including CCPs, developed at international level by the Committee on Payments and Market Infrastructures - International Organisation of Securities Committees (*CPMI-IOSCO*), and the Financial Stability Board (*FSB*).

G20 leaders endorsed the move towards *global standards* on CCP resilience, recovery planning and resolvability in September 2016.

The Proposed Regulation is consistent with existing relevant EU legislation, including EMIR and the Bank Recovery and Resolution Directive (BRRD).

Summary

The main objectives of the Proposed Regulation are:

- to ensure that CCPs' critical functions, ie those necessary for the financial markets to work, are preserved while maintaining financial stability
- to help to prevent taxpayers from bearing the costs associated with the restructuring and the resolution of failing CCPs, and
- to avoid any unnecessary destruction of value, ie higher losses or costs associated with the resolution actions that would otherwise be required to meet the resolution objectives.

The Proposed Regulation focuses on the following three elements:

A. Preparation and prevention

(i) Recovery planning

The Proposed Regulation requires CCPs to draw up and maintain recovery plans providing for measures to be taken in order to overcome financial distress or a risk of breaching their prudential requirements under EMIR. CCPs would also be required to develop indicators informing clearing participants and authorities when the plans would be triggered. The plans would not be able to rely on public financial assistance, but would need to outline the ways of obtaining access to central bank facilities.

To make recovery plans effective, all the arrangements would be agreed between CCPs and their clearing members. Clearing members, in turn, would be required to inform their clients how they would transmit to the client any losses and costs arising from the CCP's exercise of recovery tools.

Recovery plans would need to be reviewed by the supervisory college.

(ii) Resolution planning

Resolution plans would be required to be drawn up for each CCP by resolution authorities¹ and would provide for how CCPs would be restructured and their critical functions kept alive in the event of failure. Similar to recovery plans, resolution plans should not assume any public financial support besides access to central bank facilities under standard terms.

Recovery plans should outline the resolution powers and tools that would be employed in case a CCP meets the conditions for resolution, and be jointly agreed by the relevant authorities of the resolution college.

B. Early intervention

The Proposed Regulation grants competent authorities specific powers to intervene where a CCP is likely to infringe the prudential requirements or where their actions may be detrimental to overall financial stability. These powers include, among others:

- requiring the CCP to implement some of the arrangements set out in the recovery plans
- requiring the CCP to identify the causes of the infringement and draw up an action plan

¹ Resolution authorities for CCPs can be central banks, competent ministries, competent authorities or other public administrative authorities.

- requiring changes to the business strategy, legal or operational structures of the CCP, and
- providing the resolution authority with the information necessary to update the CCP's resolution plan in order to prepare for the possible resolution of the CCP and the valuation of its assets and liabilities.

C. Resolution

The Proposed Regulation provides that a failing CCP could be put into resolution by national authorities when this is in the public interest and also when:

- there are no realistic prospects of recovery over an appropriate timeframe
- all other intervention measures (such as the default management procedures foreseen in a CCP's operating rules or its recovery measures) have been exhausted or could impede the financial stability of one or more Member States, and
- winding up the CCP under normal insolvency proceedings would risk prolonged market uncertainties and financial instability.

There are several resolution tools that could be used separately or in conjunction by the resolution authority, including:

- the sale of a CCP's entire or critical functions to a viable competitor
- creation of a publicly controlled 'bridge CCP' – this involves identifying essential functions of the original CCP and separating them into a new CCP (bridge CCP) which could eventually be sold to another entity. The original CCP, left with the non-essential functions, would then be liquidated under normal insolvency proceedings
- allocation of losses and positions among clearing members, ie haircutting of variation margin and cash calls enacted by the resolution authority, and partial or full termination of contracts respectively, and
- the write-down and conversion of capital and debt instruments or other unsecured liabilities intended to absorb losses, recapitalise the CCP or bridge CCP or support the use of the 'sale of business' tool.

D. Cooperation between supervisors

CCPs operate cross-border and often internationally, so it is important that authorities cooperate across borders to ensure effective planning and orderly resolution. The Proposed Regulation, therefore, requires resolution authorities to set up resolution colleges for each CCP.

As well as the resolution authority, members of the resolution college should include competent authorities of the clearing members, CCPs, central securities depositories and trading venues present in the EMIR college, relevant central banks, the European Securities and Markets Authority (ESMA) and the European Banking Authority (EBA).

Next steps

The Proposed Regulation is currently being reviewed by the European Parliament and Council of the EU. Once each institution has determined its initial position, they will meet (with the European Commission) in trilogue negotiations to reach political agreements on the Level 1 text.

Where are we in the process?

Table 1: Key stages in development of Level 1 text

Level 1 Text	Date
<i>Commission Proposal</i>	28 November 2016

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