

III

(Preparatory acts)

EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 20 September 2017

on a proposal for a regulation of the European Parliament and of the Council on a framework for the recovery and resolution of central counterparties and amending Regulations (EU) No 1095/2010, (EU) No 648/2012, and (EU) 2015/2365**(CON/2017/38)**

(2017/C 372/05)

Introduction and legal basis

On 7 and 24 February 2017 the European Central Bank (ECB) received requests from the Council of the European Union and from the European Parliament respectively for an opinion on a proposal for a regulation of the European Parliament and of the Council on a framework for the recovery and resolution of central counterparties and amending Regulations (EU) No 1095/2010, (EU) No 648/2012, and (EU) 2015/2365 ⁽¹⁾ (hereinafter the 'proposed regulation').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union since the proposed regulation contains provisions affecting the basic tasks of the European System of Central Banks (ESCB) to define and implement monetary policy and to promote the smooth operation of payment systems pursuant to the first and fourth indents of Article 127(2) of the Treaty and the ESCB's task of contributing to the smooth conduct of policies relating to the prudential supervision of credit institutions and the stability of the financial system pursuant to Article 127(5) of the Treaty. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. General observations

- 1.1 The ECB strongly supports the Commission's initiative to establish a dedicated Union framework for the recovery and resolution of central counterparties (CCPs) as an integral component of the Union legislative framework for financial markets in which CCPs play a critical role as risk managers in many market segments. The continuity of their critical functions is essential both for the stability of the Union financial system and for the monetary policy transmission mechanism. The ECB fully supports the scope of the proposed regulation in terms of the mandates and powers of resolution authorities, CCP recovery and resolution plans and resolvability assessments, early intervention measures, resolution triggers, resolution tools and powers, including government stabilisation tools, and third country provisions. The ECB also agrees with the main thrust of the proposed regulation.
- 1.2 Nonetheless, the ECB considers that the proposed regulation could be further enhanced, especially in four areas.
 - 1.2.1 First, given the critical role of clearing participants in CCP recovery and resolution, clearing participants must be able to estimate reliably and manage their potential exposures under the proposed regulation. At the same time, the inherently implausible market events that lead to CCP recovery and resolution are impossible to foresee fully in advance, and resolution authorities therefore need sufficient flexibility for devising their actions. The ECB recommends that the proposed regulation better balances these two considerations by: (i) prioritising clearly

⁽¹⁾ COM(2016) 856 final.

measurable loss allocation tools in recovery; (ii) encouraging resolution authorities to consider entry into resolution where actions to restore a matched book and to allocate uncovered losses would result in significant and unpredictable losses for clearing participants; and (iii) providing greater *ex ante* transparency regarding resolution authorities' general approaches and decision-making processes when using their discretion in key areas of resolution. In principle, considering the overall aim of maintaining financial stability in the Union, resolution authorities should give due regard to the need to minimise adverse contagion to CCP participants and to the wider financial system.

1.2.2 Second, one key objective of CCP resolution is to ensure the continuity of the CCP's critical functions without incurring taxpayer losses. Robust arrangements to ensure the availability of adequate private sector funds, to fully allocate financial losses in resolution and to replenish CCPs' financial resources are therefore crucial. Conversely, any potential public sector support should only be considered as an absolute last resort and as a temporary measure, to avoid moral hazard and set appropriate *ex ante* risk management incentives. The ECB considers that the safeguards in the proposed regulation should be strengthened in the following ways: (a) when conducting resolution planning and resolvability assessments, resolution authorities should carefully assess the size and credibility of CCP resolution funding arrangements with specific regard to scenarios going beyond 'extreme but plausible' events and on the basis of a common criteria-based approach; (b) the potential use of government stabilisation tools as a last resort should be coupled with comprehensive and credible arrangements to recover the temporary funding in a timely manner; and (c) when implementing the 'no creditor worse off' principle to ensure that no clearing participant, CCP shareholder or creditor bears greater losses in resolution than it would have incurred under insolvency proceedings, realistic assumptions regarding the value of business continuity preserved through resolution should be applied.

1.2.3 Third, the arrangements for CCP recovery and resolution on a standalone basis should be complemented by horizontal cooperation to ensure their consistency and effective interaction:

— Significant risk externalities of CCP recovery and resolution arise not only with regard to each individual CCP for its immediate stakeholders (as recognised by the involvement of colleges of authorities for the purpose of recovery planning, resolution planning and resolvability assessments), but also across CCPs, including those operating in different jurisdictions, as a result of their reliance on a common set of banking groups acting as major clearing members and service providers. Furthermore, the severe market events associated with a CCP's failure in resolution scenarios related to member default could affect several CCPs at once. Against this background, credible recovery and resolution planning appropriate to safeguarding Union financial stability might not be achievable by focusing solely on individual CCPs on a standalone basis, but should be coordinated across Union CCPs.

— There is also a need to acknowledge the close interdependencies between CCP recovery and resolution given that recovery planning is an integral part of CCP resolution planning. Furthermore, recovery planning may be directly affected by resolution planning through measures that aim to address possible impediments to resolvability. Recovery plans, and the related contractual agreements between CCPs and clearing participants, also play a key role in determining the 'no creditor worse off' in resolution by reference to the insolvency counterfactual. Finally, it is impossible to fully delineate the boundaries between recovery and resolution in advance. Against this background, the ECB considers that the European Securities and Markets Authority (ESMA) should be entrusted with developing a holistic perspective on the ability of the Union central clearing landscape to withstand potential system-wide market events going beyond 'extreme but plausible' conditions and involving both recovery and resolution scenarios. In performing this task, ESMA should cooperate closely with the ESCB, including the ECB when performing its prudential supervision tasks, and the European Banking Authority (EBA), given the significant implications of CCP recovery and resolution for central banks in their roles as central banks of issue and overseers as well as for banking supervisors.

- 1.2.4 Fourth, given the increasingly cross-border nature of central clearing and the high degree of market competition, a level playing field across CCPs is essential. While CCPs and resolution authorities should have appropriate flexibility and discretion in devising individual recovery and resolution plans, respectively, in line with their specific needs and circumstances, there is a need for consistency of recovery and resolution plans in terms of the comprehensiveness and rigour of the embedded approaches. Therefore, such plans should be in line with relevant international standards^(?). Against this background, the ECB suggests enhancing the proposed regulation by better aligning the content of recovery and resolution plans and resolvability assessments for Union CCPs with what has been agreed and/or is under development at international level.
- 1.3 The proposed Regulation applies to all Union CCPs, regardless of whether or not they have a banking license. While the ECB in principle supports this approach, it would see merit, given the specificities of credit institutions, in further assessing whether some clarifications regarding the application of the regulation to CCPs with a banking license might be helpful, e.g. in view of potential issues arising with regard to the treatment of participant deposits protected by Directive 2014/49/EU of the European Parliament and of the Council^(?) in CCP recovery or resolution.
- 1.4 On 13 June 2017 the European Commission published a proposal for a regulation amending both Regulation (EU) No 1095/2010 of the European Parliament and of the Council⁽⁴⁾ (the 'ESMA Regulation') and Regulation (EU) No 648/2012 of the European Parliament and of the Council⁽⁵⁾ (the 'EMIR Regulation') as regards the procedures and authorities involved in the authorisation and supervision of CCPs established in the Union, including strengthening the role of the central bank of issue for certain aspects of CCP supervision and establishing a CCP Executive Session of the ESMA Board of Supervisors⁽⁶⁾. The ECB underlines that this opinion is based on the current Union legislative environment and is without prejudice to the ECB's stance on possible future measures strengthening the CCP supervisory functions and responsibilities of the central bank of issue at Union level. That said, the ECB agrees that targeted modifications may be necessary to take into account the new role of the CCP Executive Session in colleges under the EMIR Regulation and subsequently in resolution colleges. Moreover, it fully supports the approach that during the finalisation of the proposed regulation, the Commission, the Council and the European Parliament carefully assess the potential role of the CCP Executive Session in promoting the consistency and effective interaction of recovery and resolution plans across CCPs, and in monitoring and mitigating their aggregate risk implications for financial stability in the Union, as per the ECB's observations in paragraphs 1.2.3 and 1.2.4.

2. Specific observations

2.1 *Involvement of central banks in recovery and resolution*

2.1.1 Arrangements for involving central banks

A potential CCP failure implies significant financial risks that, if not managed in a timely and effective manner, could pose serious threats to interdependent financial market infrastructures and financial institutions participating in or providing services to CCPs, and ultimately could endanger both financial and monetary stability.

^(?) For international standards on the recovery of financial market infrastructures, see the report by the Bank for International Settlements (BIS) Committee on Payments and Market Infrastructures (CPMI) and Board of the International Organization of Securities Commissions (IOSCO), 'Recovery of financial market infrastructures – Revised Report' (2017), available on the BIS website at www.bis.org. For international standards on the resolution of financial market infrastructures, see the guidance set out by the Financial Stability Board (FSB) in Appendix II - Annex 1 – Resolution of Financial Market Infrastructures (FMIs) and FMI Participants annexed to Key Attributes of Effective Resolution Regimes for Financial Institutions (2014), available on the FSB's website at www.fsb.org. The FSB issued more granular guidance in 'Guidance on Central Counterparty Resolution and Resolution Planning' in July 2017. This document is also available on the FSB's website.

^(?) Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (OJ L 173, 12.6.2014, p. 149).

⁽⁴⁾ Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

⁽⁵⁾ Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.7.2012, p. 1).

⁽⁶⁾ Proposal for a regulation of the European Parliament and the Council amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs, COM(2017) 331 final.

Appropriate CCP recovery and resolution arrangements to ensure that these risks are averted in an effective and timely manner are therefore of direct relevance for central banks' responsibilities for defining and implementing monetary policy, promoting the smooth operation of payment systems, contributing to financial stability and, where relevant, supervising credit institutions. Furthermore, central banks should have a prominent role in both the design and execution of CCP recovery and resolution strategies in their capacity as: (a) overseers; (b) providers of critical payment and settlement services to CCPs; and (c) potential providers of liquidity to CCPs and/or major clearing members, which is provided at the discretion of the central banks concerned and in accordance with the relevant rules.

The ECB stresses the need for ESMA to cooperate for the purposes of the proposed regulation not only with the European Insurance and Occupational Pensions Authority (EIOPA) and the EBA, but also with the ECB/ESCB in connection with the performance of the ESCB's tasks of defining and implementing monetary policy and of promoting the smooth operation of payment systems, and the ECB's tasks concerning the prudential supervision of credit institutions⁽⁷⁾. In this regard, EU central banks of issue and CCP overseers should be involved in the horizontal cooperation with regard to CCP recovery and resolution across Union CCPs, as explained in paragraph 2.2, and the development of regulatory technical standards (RTS) for the technical details of resolution plans, resolvability assessments, and the functioning of resolution colleges as set out in paragraphs 2.2, 2.4 and 2.5.

2.1.2 Voting arrangements in resolution colleges

Pursuant to Article 4(1) and (2) of the proposed regulation, the resolution authority must establish, manage and chair a resolution college that comprises, among other members, the central banks of issue of the most relevant Union currencies of the financial instruments cleared⁽⁸⁾ and the competent authorities responsible for the supervision of the clearing members of the CCP that are established in the three Member States with the largest contributions to the default fund of the CCP⁽⁹⁾.

Where the Eurosystem central banks, which together form the 'central bank of issue' for the euro, are represented by the ECB or a national central bank (NCB), and the prudential supervision of credit institutions that are significant CCP clearing members is performed by the ECB, separate votes should be attached to these two roles. As the ECB has already stressed⁽¹⁰⁾, these two functions are distinct and pursue different objectives, as is reflected in the operational separation between the ECB's monetary policy and prudential supervisory roles.

2.1.3 Central banks as clearing participants

The proposed regulation⁽¹¹⁾ lays down rules and procedures relating to the recovery and resolution of CCPs authorised in accordance with Regulation (EU) No 648/2012. By necessary implication, its provisions apply not only to CCPs but, also, to CCP clearing participants, meaning clearing members and clients⁽¹²⁾. In connection with their operations under the Treaty and national legislation, the members of the ESCB may act both in the capacity of a clearing member and a client. If resolution authorities were to decide, at their discretion, to activate the position and loss allocation tools under the proposed regulation, this would imply that central banks acting as CCP clearing members or clients in connection with their statutory operations would participate in financial loss sharing. This would entail the risk that such losses could undermine a central bank's balance sheet position

⁽⁷⁾ See Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

⁽⁸⁾ See Article 4(2)(h) of the proposed regulation.

⁽⁹⁾ See Article 4(2)(c) of the proposed regulation.

⁽¹⁰⁾ See the ECB response to the Commission consultation on the review of the European Market Infrastructure Regulation (EMIR), available on the ECB's website at www.ecb.europa.eu.

⁽¹¹⁾ See Article 1 of the proposed regulation.

⁽¹²⁾ See point (17) of Article 2 of the proposed regulation.

and compromise its reputation. Furthermore, the proposed framework should take account of the special features of central banks as CCP clearing participants, whilst bearing in mind the root cause of a CCP's potential failure, namely the default of one or more of its clearing members. Central banks differ from other CCP clearing participants, as central banks are, by definition, solvent and not prone to failure, on account of their special status, which is linked to the public law nature of their mandate. Given the limited risks posed by central banks as CCP clearing participants, certain CCPs will allow central banks to be admitted as clearing members under modified conditions. It is, therefore, difficult to accept that CCP clearing participants such as central banks, which create no risks for the CCPs in which they participate, should bear costs associated with the failure of those CCPs, including in a resolution scenario. Finally, in terms of consistency with the objectives of the proposed regulation, it is important to avoid creating moral hazard issues or misperceptions with regard to the role of central banks. An increase in the exposures of the members of the ESCB to a failing CCP would contradict the underlying rationale of the proposed regulation, which is to prevent reliance on public money to preclude a CCP's failure. Consequently, the ECB proposes that the members of the ESCB should be exempted when acting as CCP clearing participants from the position and loss allocation tools set out in Articles 28 to 31 of the proposed regulation.

2.1.4 Central banks as resolution authorities

The proposed regulation provides that NCBs may be designated as resolution authorities for CCPs⁽¹³⁾. At the same time, NCBs have a statutory role to promote the smooth operation of payment systems and to contribute to the smooth conduct of policies relating to the stability of the financial system, in addition to providing relevant expertise on financial market infrastructures. Notwithstanding this existing statutory role, where, on the basis of the proposed regulation, a Member State designates an NCB as the resolution authority for CCPs, the specific details of the proposed conferral of that task on the NCB would have to be assessed by the ECB against the prohibition on monetary financing under Article 123 of the Treaty⁽¹⁴⁾.

In addition, although, according to the proposed regulation, an NCB (in its capacity as resolution authority) may own, wholly or partially, a bridge CCP⁽¹⁵⁾, the NCB may not assume or finance any of the bridge CCP's obligations. The NCB's role as owner of such an entity must, under all circumstances, remain consistent with the prohibition on monetary financing under Article 123 of the Treaty, and it must perform the role of owner without prejudice to its financial and institutional independence⁽¹⁶⁾. In the same vein, the ECB emphasises that, in line with Article 123 of the Treaty, which prohibits, *inter alia*, any financing of the public sector's obligations vis-à-vis third parties, NCBs may not finance any of the additional financing arrangements⁽¹⁷⁾ deemed necessary to ensure the effective use of resolution tools⁽¹⁸⁾. This is without prejudice to the competence of central banks to decide independently and at their full discretion, separately from their potential role as resolution authorities, on the provision of central bank liquidity to solvent entities, in accordance with the relevant rules and within the limits imposed by the monetary financing prohibition under the Treaty.

2.2 EMIR colleges, resolution colleges and the ESMA resolution committee

The ECB supports the overall framework for the functioning of the EMIR colleges and of the resolution colleges for the purposes of cooperation on recovery planning, resolution planning, resolvability assessments and resolution. However, given the need for the effective involvement of central banks and bank supervisors both in the design and execution of CCP recovery and resolution strategies, the ECB recommends that the RTS specifying the functioning of resolution colleges should be developed in close cooperation with the ESCB, including the ECB when performing its prudential supervision tasks, and the EBA.

Furthermore, as stated in paragraph 1.2.3, the arrangements for colleges at the level of each individual CCP should be complemented with a horizontal structure to consider recovery and resolution arrangements across CCPs throughout the Union. In order to promote consistent approaches and the effective interaction of recovery and resolution arrangements across Union CCPs, ESMA should assess CCP recovery and resolution arrangements

⁽¹³⁾ See Article 3(1) of the proposed regulation.

⁽¹⁴⁾ See paragraphs 2.2 and 2.3 of Opinion CON/2017/2. All ECB opinions are published on the ECB's website at www.ecb.europa.eu

⁽¹⁵⁾ See Article 42(2) of the proposed regulation.

⁽¹⁶⁾ See paragraph 3.3 of Opinion CON/2012/99 of the European Central Bank of 29 November 2012 on a proposal for a directive establishing a framework for recovery and resolution of credit institutions and investment firms (OJ C 39, 12.2.2013, p. 1).

⁽¹⁷⁾ See Article 44 of the proposed regulation.

⁽¹⁸⁾ See paragraph 3.4 of Opinion CON/2012/99.

in terms of their aggregate effect on Union financial stability through regular stress-testing and crisis simulation exercises with respect to potential system-wide stress events. A combined assessment of the impact of CCP recovery and resolution arrangements is warranted in view of the peculiarities of the recovery and resolution process for CCPs. In contrast to the arrangements in place for banks, CCP resolution relies to the greatest possible extent on the recovery process. Under the proposed regulation, resolution authorities are required, subject to certain derogations, to enforce CCPs' existing or outstanding contractual obligations before using any resolution tools⁽¹⁹⁾. In addition, where a deviation from a CCP's operating rules in resolution has led to its clearing members being worse off than they would have been in liquidation, they will be entitled to compensation⁽²⁰⁾.

Unlike banks, CCPs do not take on financial risk themselves but manage it on behalf of their clearing members, while the position and loss allocation tools rely essentially on a CCP's clearing members. Against this background, the supervisors and resolution authorities for CCPs and banking supervisors should cooperate closely in recovery and resolution planning to ensure that banks can appropriately prepare for and manage related obligations, thereby also reducing the risk that CCP recovery and resolution could give rise to adverse contagion effects in the wider financial system. Similarly, there is a need to closely coordinate with central banks in their roles as central banks of issue and overseers, as set out in paragraph 2.1.1. Therefore, in performing its horizontal tasks with regard to recovery and resolution planning, ESMA should cooperate with the ESCB and banking supervisors, including the ECB when performing its prudential supervision tasks. Consistent with this, the proposed regulation should include more generally a requirement for ESMA to cooperate with the ESCB.

Finally, there may be a need to reconsider the ECB's position as to the authority which should be mandated with the horizontal assessment of CCP recovery and resolution arrangements once the current review of Union legislation on CCP supervision initiated with the Commission's proposal of 13 June 2017 will have been finalised.

2.3 Recovery planning

2.3.1 Content of recovery plans

The content of recovery plans under the proposed regulation requires more detailed specification. In particular, the key objective of recovery planning should be specified expressly in terms of ensuring the availability of a set of recovery tools that is comprehensive and effective in allowing a CCP to allocate any uncovered losses and cover liquidity shortfalls, address unbalanced positions and replenish financial resources, including the CCP's own capital, so that it can continue to provide critical services.

Broadly consistent with the proposed regulation's provisions on the content of resolution plans⁽²¹⁾, CCPs should as a minimum be required to differentiate, also in their recovery plans, between potential stress scenarios that are due to a clearing member's default and those that are due to other reasons, and to take into consideration a combination of these recovery scenarios and potential system-wide events. As regards default-related losses, it will be important to ensure that the scenarios reflected are sufficiently severe, and CCPs should therefore be required to take into account the potential default of more than two of their largest clearing members. As regards non-default losses, CCPs should, in line with the 2017 report on recovery adopted by the CPMI and IOSCO⁽²²⁾, be required expressly to consider investment losses, general business losses and, where applicable, risks associated with the failure of a third party to perform a critical function for the CCP.

In addition, consistent with the proposed regulation's requirements for resolution plans⁽²³⁾, it should be expressly specified that recovery plans must assume not only the absence of extraordinary public financial support, but also the absence of central bank emergency liquidity assistance, or central bank liquidity assistance provided under non-standard collateralisation, tenor or interest rate terms.

⁽¹⁹⁾ See Article 27(3) and (4) of the proposed regulation.

⁽²⁰⁾ See Article 27(5) of the proposed regulation.

⁽²¹⁾ See Article 13(3) of the proposed regulation.

⁽²²⁾ See footnote 2.

⁽²³⁾ See Article 13(4) of the proposed regulation.

The requirements for recovery plans to consider the interests of all stakeholders that are likely to be affected by the plan and to ensure that clearing members do not have unlimited exposures towards the CCP, should be moved from the annex to the main text of the proposed regulation, given the essential nature of these requirements.

Finally, the sequencing of loss allocation tools in recovery plans should be specified. Given how crucial it is that clearing participants are in a position to measure, manage and control their potential exposures in recovery to the greatest extent possible, tools which can be fully quantified *ex ante* (such as capped cash calls) should be prioritised over other loss allocation tools where the eventual amounts at stake will largely depend on market movements and positions held at an uncertain point in the future when recovery is initiated.

2.3.2 Assessment of recovery plans

The ECB welcomes the role of the resolution authority in examining the recovery plan in order to identify any measures which may adversely impact on the resolvability of the CCP and making recommendations on those matters to the competent authorities⁽²⁴⁾. This is a critical safeguard considering that CCP recovery plans are taken as the starting point for CCP resolution. In order to ensure that this provision works effectively, the ECB recommends clarifying that the resolution authority's review may take place not only in the context of the initial approval of the recovery plan, but also at a later stage, when the resolution authority conducts or updates its assessment of the CCP's resolvability. This is important as resolution authorities are likely only to conduct their resolution planning and resolvability assessments after the CCP's recovery plan has been finalised.

2.3.3 Coordination procedure for recovery plans

The ECB considers that the voting procedure in relation to recovery plans, to be used by the colleges established under Regulation (EU) No 648/2012⁽²⁵⁾, should be aligned with the procedure for college opinions set out in Article 17(4) and 19 of that Regulation. To specify that voting of a two-thirds majority of the college will be needed to trigger ESMA mediation if a unanimous decision of the college cannot be reached within a predetermined period⁽²⁶⁾ is likely to be more effective in fostering timely decision-making by the college and reducing the need for mediation by ESMA in reaching a college opinion. Moreover, this approach would strengthen the involvement of all relevant competent authorities that could be affected by the college's decision.

2.4 Resolution planning

2.4.1 Content of resolution plans

In line with the ECB's suggestions for the content of recovery plans set out in paragraph 2.3.1, the ECB considers that resolution plans should further differentiate the failure scenarios not related to a clearing member's default⁽²⁷⁾. Similarly, in order to ensure that resolution plans are adequate for all relevant scenarios going beyond 'extreme but plausible' conditions, the resolution plan should, in terms of default-related failure scenarios, take into consideration not only the default of one or more of the CCP's clearing members⁽²⁸⁾, but also the default of at least the three clearing members to which the CCP has the largest exposures, considering that CCPs are already required under Regulation (EU) No 648/2012 to hold sufficient financial resources to withstand the potential default of at least the two clearing members to which the CCP has the largest exposures.

⁽²⁴⁾ See Article 10(4) of the proposed regulation.

⁽²⁵⁾ See Article 12(2) to (5) of the proposed regulation.

⁽²⁶⁾ This would imply that if a majority of two-thirds of college members have expressed a negative opinion on the recovery plan any of the authorities concerned may transfer the matter to ESMA for mediation.

⁽²⁷⁾ See Article 13(3) of the proposed regulation.

⁽²⁸⁾ See Article 13(3)(a)(i) of the proposed regulation.

The ECB welcomes the requirement for a resolution plan not to assume extraordinary public financial support, central bank emergency liquidity assistance or central bank liquidity assistance provided under non-standard collateralisation, tenor and interest terms⁽²⁹⁾. At the same time, given the importance of pre-empting potential taxpayer losses in resolution, the ECB recommends that the proposed regulation also expressly requires a resolution authority to make prudent assumptions about the financial resources that may be required to achieve resolution objectives and the resources that it expects to be available under the CCP's rules and arrangements at the time of entry into resolution.

In order to ensure better consistency between the key aspects of the resolution plan⁽³⁰⁾ and international standards, the ECB recommends adding the following items to the minimum content of resolution plans.

- An estimation of the timeframe for the replenishment of the financial resources of the CCP (i.e. default fund and regulatory capital).

- A description of the general approach and decision-making processes followed by the resolution authority in key areas of resolution with the objective of fostering planning and stakeholder transparency around prospective resolution actions⁽³¹⁾. This should include: (a) the resolution authority's prospective approach for triggering resolution, including key indicators that would influence the resolution authority's decision whether to put the CCP in resolution in different types of default and non-default related resolution scenarios; and (b) to the extent that the resolution authority needs to depart from the CCP's rules and arrangements, the general approach that the resolution authority would expect to follow in calculating and allocating losses, including the presumed choice and sequencing of different loss allocation tools, and how the resolution authority would expect to apply the 'no creditor worse off than in insolvency' safeguard and assess losses under the counterfactual for these purposes.

- A description of the information sharing arrangements within the resolution college during resolution⁽³²⁾.

The ECB welcomes the fact that the proposed regulation provides for the development of RTS for the technical details of resolution plans⁽³³⁾. However, the ECB stresses that these RTS should be developed in close cooperation with the ESCB, including the ECB when performing its prudential supervision tasks, and the EBA. Involvement of the ESCB is particularly important, given the key role that central banks of issue play in facilitating continued access to critical payment and settlement services and in the provision of liquidity in accordance with their respective mandates.

2.4.2 Coordination procedure for resolution plans

In line with the ECB's suggestions for the coordination procedure for recovery plans set out in paragraph 2.3.3, the ECB considers that the voting procedure to be used by the resolution college in relation to resolution plans⁽³⁴⁾ should be aligned with the procedure set out in Article 17(4) and Article 19 of Regulation (EU) No 648/2012.

2.5 *Resolvability*

2.5.1 Content of resolvability assessments

The ECB considers that the technical aspects to be considered by the resolution authority when assessing the resolvability of a CCP should be set out in RTS and not in an annex to the proposed regulation⁽³⁵⁾. These RTS should be developed in close cooperation with the ESCB, including the ECB when performing its prudential supervision tasks, and the EBA.

⁽²⁹⁾ See Article 13(4) of the proposed regulation.

⁽³⁰⁾ See Article 13(6) of the proposed regulation.

⁽³¹⁾ See section 7.5 (i) and (v) of the FSB's 'Guidance on Central Counterparty Resolution and Resolution Planning'.

⁽³²⁾ *Ibid.*, section 7.5 (xiii).

⁽³³⁾ See Article 13(8) of the proposed regulation.

⁽³⁴⁾ See Article 15 of the proposed regulation.

⁽³⁵⁾ See Article 16(4) of the proposed regulation.

The ECB welcomes the power of the resolution authority to require a CCP to set aside resources to increase the capacity for loss absorption, recapitalisation and the replenishment of pre-funded resources, should the available resolution funding be deemed insufficient⁽³⁶⁾. In order to give effect to this power, the RTS on the assessment of resolvability should specify minimum criteria to be considered by resolution authorities when assessing the adequacy of a CCP's resolution funding. This aspect is currently not covered by the proposed regulation⁽³⁷⁾. As a minimum the resolution authority should take into account the following elements⁽³⁸⁾:

- in the event of default-related resolution scenarios: (a) the risk characteristics, complexity and pricing uncertainties of the products cleared, and the related potential margin of error in initial and variation margin calculations; (b) the size, structure and liquidity of the underlying market in stressed conditions; (c) the number of clearing member defaults that would be covered by available pre-funded and committed resources under 'extreme but plausible' conditions; (d) the availability and potential impact on affected clearing participants of tools such as partial tear-up and variation margin gains haircutting; and (e) the credibility of unfunded arrangements in meeting the CCP's potential needs; and

- in addition, and for all types of loss, the substitutability of the CCP in the markets it serves, and the credibility of any additional arrangements, such as insurance agreements or parental guarantees, that may be available to address uncovered credit losses.

Furthermore, as any requirement by a resolution authority, in accordance with point (l) of Article 17(7), for a CCP to issue bail-in-able liabilities as a loss-absorbing instrument may be difficult to reconcile with the role and business model of CCPs as risk managers, a thorough impact assessment should be conducted before making use of this power.

Finally, in drafting the RTS on the assessment of resolvability, ESMA should take into account forthcoming assessments or reports drawn up by the FSB on financial resources for CCP resolution⁽³⁹⁾.

2.5.2 Coordination procedure for resolvability assessments

In line with the ECB's suggestions for the coordination procedure for recovery and resolution plans set out in paragraphs 2.3.3 and 2.4.2, the ECB considers that the voting procedure to be used by the resolution college in relation to the assessment of resolvability⁽⁴⁰⁾ should be aligned with the procedure set out in Article 17(4) and Article 19 of Regulation (EU) No 648/2012.

2.6 Resolution

2.6.1 Resolution objectives

The ECB considers that the resolution objective that refers to the protection of public funds by minimising reliance on extraordinary public financial support⁽⁴¹⁾ should be expanded to include an express reference to minimising the risk of potential taxpayer losses, given that temporary public funding arrangements could be designed in different ways in terms of their safeguards to reduce potential risks for taxpayers.

⁽³⁶⁾ See Article 17(7)(l) of the proposed regulation.

⁽³⁷⁾ See Section C of the Annex to the proposed regulation on matters that the resolution authority is to consider when assessing the resolvability of a CCP.

⁽³⁸⁾ See section 6 of the FSB's 'Guidance on Central Counterparty Resolution and Resolution Planning'.

⁽³⁹⁾ The FSB will continue its work on financial resources for CCP resolution and, based on further analysis and experience gained in resolution planning, determine by the end of 2018 whether there is a need for any additional guidance. See the introduction to the FSB's 'Guidance on Central Counterparty Resolution and Resolution Planning'.

⁽⁴⁰⁾ See Article 18 of the proposed regulation.

⁽⁴¹⁾ See Article 21(1)(d) of the proposed regulation.

2.6.2 Conditions for resolution

As the boundary between recovery and resolution is very difficult to determine *ex ante* and well-timed entry into resolution is key to ensuring effective resolution and avoiding any unnecessary destruction of economic value, it is crucial that competent authorities and resolution authorities cooperate closely in the lead-up to resolution. Therefore, the ECB considers that the competent authority should provide the resolution authority, without delay and at its own initiative, with any information that may suggest that the CCP is failing or is likely to fail, and not act only in response to information requests from the resolution authority ⁽⁴²⁾.

Furthermore, given the objective of maintaining systemic stability, one priority in CCP recovery and resolution is to avoid unpredictable and significant losses for CCPs' clearing members. CCP recovery and resolution will not be effective if it is primarily based on the expectation that clearing members will be able to shoulder significant payment obligations. The potential failure of other clearing members due to sudden exposures they are unable to manage could also exacerbate existing strains within the financial system, especially given the interconnectedness of CCPs. The deployment of loss allocation tools associated with very significant, unpredictable costs for clearing members should therefore be exercised preferably by the resolution authority and not by the CCP itself during recovery. The resolution authority is likely to be in a better position than the CCP to weigh up the implications of a particular course of action for financial stability. Against this background, the ECB recommends clarifying in the proposed regulation that the resolution authority is authorised to take resolution action in cases where the CCP: (a) is or is likely to be unable to return to a matched book and to allocate uncovered losses; or (b) will only be able to return to a matched book and to allocate uncovered losses with recovery actions that may create significant and unpredictable losses for the CCP's clearing members.

2.6.3 Resolution tools

In order to pre-empt moral hazard and minimise potential taxpayer losses, the use of government stabilisation tools ⁽⁴³⁾ should not only be subject to the condition of approval under the Union State aid framework ⁽⁴⁴⁾, but should also be dependent on credible mechanisms for the timely and comprehensive recovery of any resources provided.

As regards position allocation tools, the ECB considers that partial tear-up should in principle be prioritised over full tear-up, given the key resolution objective of preserving the continuity of a CCP's critical functions. It therefore recommends that full tear-up be applied only in situations where the resolution authority considers that no other option would result in a better outcome for financial stability.

2.6.4 Resolution funding

Given the key objective of the proposed regulation to avoid taxpayer losses in CCP resolution, the ECB considers that the provisions on government stabilisation tools do not sufficiently clarify the necessary safeguards. As a minimum, and as set out in international guidance by the FSB ⁽⁴⁵⁾, the proposed regulation should include as a last resort, among the conditions for the use of government stabilisation tools, a requirement for resolution authorities to: (a) define a clear timetable for the recovery of any resources provided; and (b) ensure that effective and credible arrangements for recovering these resources are in place. In this context, the ECB also considers that the recovery of expenses incurred in connection with the use of government stabilisation tools ⁽⁴⁶⁾ should be

⁽⁴²⁾ See Article 22(1) of the proposed regulation.

⁽⁴³⁾ See Article 27 of the proposed regulation.

⁽⁴⁴⁾ This is understood, in accordance with the definition set out in Article 2(1)(53) of Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190), as the 'framework established by Articles 107, 108 and 109 TFEU and regulations and all Union acts, including guidelines, communications and notices, made or adopted pursuant to Article 108(4) or Article 109 TFEU'.

⁽⁴⁵⁾ See section 6 of the FSB's 'Guidance on Central Counterparty Resolution and Resolution Planning'.

⁽⁴⁶⁾ See Article 27(9) of the proposed regulation.

broadened. The ECB supports the existing proposal that expenses should be recovered in the first instance from the CCP under resolution, its purchaser or from the proceeds generated as a result of the termination of a bridge entity. However, these sources may not be sufficient to cover all the expenses incurred. Therefore, resolution authorities should also be required to seek *ex-post* recovery of public funds from clearing members in accordance with the CCP's rules and arrangements, while mitigating risks to financial stability.

2.7 *'No creditor worse off than in insolvency' principle*

The 'no-creditor-worse-off-than-in-insolvency' (NCWO) principle is a critical safeguard to ensure that CCP participants, shareholders and other creditors would not be treated less favourably in resolution than under the hypothetical alternative scenario where the resolution authority would not have intervened and the CCP would have been liquidated under applicable insolvency law. At the same time, it is important that the valuation methodology underlying the application of the NCWO principle properly reflects the fair value of business continuity preserved by CCP resolution in order to avoid excessive compensation claims by relevant stakeholders. The need for a fair and balanced approach in this respect is underlined by the related risks for the public sector, with the financial burden ultimately being borne by taxpayers. Taking proper account of the fair value of business continuity preserved by CCP resolution is an essential consideration in the context of CCP resolution, which would only be envisaged to take place in exceptionally severe market events, where the disruption of a CCP's critical functions would most likely be associated with a large-scale destruction of financial value and very limited opportunities for bilateral clearing alternatives.

Against this background, the ECB considers that a fair valuation of the CCP for purposes of the application of the 'no creditor worse off than in insolvency' principle would need to be not only carried out in terms of the assets and liabilities reflected on the CCP's balance sheet at the point in time when resolution is triggered, but would need to be based on a more comprehensive, realistic assessment of the CCP's value in the event of its liquidation, taking full account of losses, replacement costs, and the destruction of value that would result from service closure or the liquidation of the CCP.

2.8 *Technical observations and drafting proposals*

Where the ECB recommends that the proposed regulation should be amended, specific drafting proposals are set out in a separate technical working document accompanied by an explanatory text to this effect. The technical working document is available in English on the ECB's website.

Done at Frankfurt am Main, 20 September 2017.

The President of the ECB

Mario DRAGHI
