

MEMO# 30498

January 4, 2017

European Commission Issues Proposed Regulations to Address the Recovery and Resolution of Clearinghouses

[30498] January 4, 2017 TO: Derivatives Markets Advisory Committee
ICI Global Trading & Markets Committee
International Committee
Securities Operations Advisory Committee RE: European Commission Issues Proposed Regulations to Address the Recovery and Resolution of Clearinghouses

The European Commission recently proposed a regulation that would govern the recovery and resolution of central counterparties (CCPs) in the European Union.^[1] The proposal would provide a European Union-level framework for the recovery and resolution of CCPs to ensure that CCPs are subject to similar tools and procedures to address their possible distress or failure. The two main objectives of the proposal are to seek the orderly recovery of a financially distressed CCP through the implementation of a robust and comprehensive recovery plan and, if recovery efforts fail, to resolve the CCP in a manner that safeguards financial stability, ensures the continuity of the CCP's critical functions and protects EU taxpayers as much as possible. The European Parliament and Council will now consider whether to adopt or amend this proposal.

We have scheduled a call to discuss this proposed regulation on **Wednesday, January 11 at 11:00 am**. To receive dial-in information for the call please contact Helenia Walker at helenia.walker@ici.org.

CCP Recovery Procedures

The proposal recognizes that the financial situation of a CCP may deteriorate due to clearing member defaults or other reasons and would require the CCP to establish a plan for recovering from this condition. The explanatory memorandum to the proposed regulation notes that CCPs have broad discretion to determine the appropriate range of options and recovery tools available, including tearing up contracts and haircutting variation margin payments due to clearing participants.^[2] The memorandum further notes that clearing members must fully inform clients if they would transmit any losses or costs arising from a CCP's exercise of recovery tools to their clients.^[3] A CCP would be required to update its recovery plan at least annually and to submit its recovery plans to its competent authority for approval. The proposal also would require the recovery plan to form part of the operating rules of the CCP.^[4]

Resolving a Failed CCP

The explanatory memorandum to the proposal explains that 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 jeopardize the public interest and financial stability.^[5] The proposal would require EU member states to establish resolution authorities for CCPs. These resolution authorities could be central banks, competent ministries, regulators of CCPs, or other public administrative authorities.^[6] The proposal also would require resolution authorities to set up and chair resolution colleges for each CCP under their jurisdiction.^[7]

The proposal would require CCP resolution authorities to prepare resolution plans for the CCPs under their jurisdiction. These plans would outline the resolution powers and tools that authorities would employ to resolve a CCP. Resolution authorities would be required to review and, if appropriate, update resolution plans annually.^[8]

The proposal would authorize resolution authorities to exercise a wide variety of tools and powers in connection with the resolution of a failed CCP. The tools available to a resolution authority include: (1) full or partial termination of contracts; (2) variation margin haircutting; (3) requiring non-defaulting clearing members to make cash contributions to the CCP up to an amount equivalent to their contribution to the CCP's default fund; (4) writing down and converting ownership and debt instruments or other unsecured liabilities; (5) sale of the CCP's business; (6) creating a bridge CCP; and (7) seeking public financial support for the recapitalization of a CCP in exchange for an ownership interest in the CCP.^[9] The proposal would authorize resolution authorities to use powers necessary to use the resolution tools effectively.

Other Provisions for Recovery or Resolution of CCPs

The proposal recognizes that distress or failure of a CCP can have international spill-over effects, particularly when the CCP and its clearing members are established in different jurisdictions. To improve the enforceability of an EU authority's action on clearing members located in third countries, the proposal would require CCPs to ensure that the actions in their recovery plans are binding across jurisdictions.^[10] The explanatory memorandum also encourages authorities to enter into cooperation agreements with authorities in third countries regarding the treatment of assets or contracts governed by the laws of the third country.^[11]

The proposal also includes a temporary moratorium on certain obligations of a CCP and stays on the ordinary rights of counterparties to terminate and close-out against the CCP arising solely out of the exercise of resolution powers with respect to the CCP.

Amending EMIR to Permit the Suspension of the Clearing Obligation

The proposal would amend EMIR to allow the European Commission to suspend temporarily a clearing obligation if necessary to preserve financial stability and market confidence and to avoid contagion effects from a failed CCP and to prevent counterparties and investors having high and uncertain risk exposures to a failed CCP.^[12]

Jennifer S. Choi
Associate General Counsel

George M. Gilbert

endnotes

[1] European Commission, 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 (November 28, 2016), *available at* <https://ec.europa.eu/transparency/regdoc/rep/1/2016/EN/COM-2016-856-F1-EN-MAIN.PDF> (Proposed Regulation).

[2] *See id.* at 13.

[3] *See id.*

[4] *See id.* at 47.

[5] *See id.* at 14. A CCP would be deemed to be failing or likely to fail where one or more of the following circumstances apply: (1) the CCP infringes or is likely to infringe its authorization requirements in a way that would justify the withdrawal of its authorization; (2) the CCP is unable or is likely to be unable to provide a critical function; (3) the CCP is unable or is likely to be unable to restore its viability through the implementation of its recovery measures; (4) the CCP is unable, or is likely to be unable to pay its debts or other liabilities as they fall due; or (5) the CCP requires extraordinary public financial support. *See id.* at 61.

[6] *See id.* at 39.

[7] Article 4 of the proposal addresses the composition of the resolution colleges, which largely mirror the composition of the resolution colleges for CCPs established by the European Market Infrastructure Regulation (EMIR).

[8] *See* Proposed Regulation at 50-51.

[9] *See id.* at 14-15.

[10] *See id.* at 16.

[11] *See id.*

[12] *See id.* at 103-4.

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