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EBF comments on the forthcoming Commission initiative on Recovery and Resolution of Central Counterparties (CCPs)

Introduction

CCPs are systemically important institutions and many of them are active internationally. The systemic importance of CCPs is growing due to global regulatory requirements to centrally clear derivatives and due to market trends. This is the reason why the Commission is currently working on a proposal on a Recovery and Resolution framework for CCPs.

The EBF believes that the following key points should be taken into account when developing such a proposal.

Key points

- The EBF believes that the recovery and resolution procedures that have been developed for banks should not be transposed to CCPs without consideration regarding their specific characteristics and market function. Recovery and resolution procedures for CCPs will need to be specifically adapted and tailored and should differentiate between the event of a clearing member default and other (non-default) events.
- The objective of a CCP recovery and resolution regime should be securing the continuity of a CCP's clearing services and the functions and services necessary to continue this service. These need to be carefully identified. No other functions should be included in the recovery and resolution process.
- A CCP recovery and resolution regime has to be flexible enough to cover both different business models of CCPs as well as different risk-profiles with different instruments (one size does not fit all -approach). It must also recognize that there are two types of CCP failure: a) a CCP that has become insolvent due to management failures and/or poor investment decisions and b) the default of a clearing member(s) results in the CCP exhausting its financial safeguards to such an extent that it is unable to maintain its clearing service(s). Each of these scenarios requires different tools and policy responses, and should have different consequences for stakeholders.

- The EBF believes there is a need not only to strike a balance between clearing members and shareholders of the CCPs, but also to take into account the rights and obligations of the “clients of clearing members” and potentially of their own clients if any; all those types of clients are currently legally bound to find clearing solutions as per EMIR and MiFID 2/ MiFIR.
- The links between CCPs (known as interoperability arrangements) could have a potential systemic impact to the CCPs that are interconnected to the defaulting one. This should be taken into account when discussing the composition of the college of regulators overseeing the decisions around the actual recovery or resolution of a CCP.
- Serving a multifaceted role as both users and supporters of CCPs¹, banks are particularly exposed to the damaging consequences of a CCP failure. During times of market stress, these same banks are – by virtue of their role as a clearing member – also liable to contribute resources in order to ensure the CCP’s stability. Clearing members should therefore have an important voice regarding the governance, exposure to risks and recovery and resolution planning of CCPs.
- Both the recovery and the resolution regime should be clear, transparent and workable. It should be designed jointly with participants and should be predictable on an ex-ante basis. In addition, access to information and decision making should be granted to all stakeholders that may need to contribute in the event of a recovery and/or resolution.
- Recovery and resolution tools should be transparent and designed to allow those who would bear losses to measure, manage and control their exposure risks, in particular the potential losses. There should be no unlimited exposures for clearing members, indirect participants or clients.
- There should be a process at the European level to temporarily suspend the clearing obligation. Such a process is urgently needed if a CCP enters into recovery and resolution.
- The criteria for entry into resolution and for who will take that decision need to be well identified and must be founded on a clear legal basis.
- Margin haircutting should, if at all considered, only be a very last resort and then should only be applied to variation margin and not initial margin. Margining is a cornerstone of the risk mitigation mechanism designed to protect not only the CCP but also other counterparties from financial difficulties. If this risk mitigation mechanism no longer functioned reliably, the danger of systemic contagion would increase immediately. Additionally, haircutting in the CCP recovery phase should be seen as a bail-in instrument (in respect of the clearing member’s repayment claims against the CCP) rather than as a tool to replenish the CCP’s

¹ Serving as members, creditors, liquidity providers, depositories, custodians, settlement banks and intermediaries for the benefit of both direct and indirect clients, few institutions have as complex or as multifaceted relationships with CCPs as do banks



funds as this would disrupt the risk mitigation mechanism and contradict the idea that collateral posted should be insolvency remote.

- Furthermore, the EBF believes it needs to be absolutely clear what is meant by “haircutting” in the discussion on “margin haircutting”. In order to prevent misconceptions with systemic consequences, a precise definition is indispensable. If haircuts relating to margins are considered at all, it should be ensured that these are not applied to the margin itself, i.e. the collateral posted, but only to the repayment claims of the clearing member towards the CCP in relation to the margin.
- The EBF does not believe that initial margin haircutting is an appropriate recovery and resolution tool on the grounds that it:
 - Incentivizes clearing participants to exit trades in a disorderly manner rather than focus on better risk management and participate in the CCP default management process;
 - Is not guaranteed to be of a sufficient size to cover uncovered CCP liabilities;
 - Would disincentivize market participants from using clearing services at all;
 - Would cause conflicts with jurisdictions where initial margin must be posted on a bankruptcy remote basis.
- With respect to other potential tools (temporary stay, moratorium) the EBF believes these tools require careful consideration in their scope and application. Furthermore, the EBF would like to point to the safeguards that need to be observed such as: very narrow time frame of the application of a tool, clearly defined beginning and end with only a strictly limited time of the application of the tool, no cherry-picking, and reactivation of rights after the application of the tool.
- We are very concerned about the potential pro-cyclical danger that the use of mandatory cash calls in an already stressed situation could present. Cash calls should be limited on an ex ante basis and should also be proportional to participant’s exposures to the CCP. The EBF is very skeptical about the concept of “uncapped cash call” as even such cash calls have to be measurable and controllable for the participant.
- The “no creditor worse-off” principle should be respected in any case.
- All tools that contain an element of debt relief for the CCP in crisis or even result in payment obligations for the direct or indirect clearing members and other creditors should be combined with an obligation for the CCP to issue a debtor warrant in return.
- Regarding the powers of a resolution authority, the objectives of, the use of these powers, under what conditions they can be used, and what discretion the authorities will have in their application must be clear. This is especially important in the context of the EU, where a CCP failure will have significant cross-border implications. The EBF believes that a CCP recovery and resolution regime must also be clear as to its extraterritorial effects and globally consistent as far as possible.

