

Response to the ESMA consultation paper

Draft RTS further specifying the factors that shall be considered by the competent authority and the supervisory college when assessing the CCP recovery plan (Article 10(12) CCPRRR)

Introduction

The Futures Industry Association (FIA) and the International Swaps and Derivatives Association (ISDA), together the Associations, represent the largest number of global and national participants in clearing, banking and financial markets. The Associations appreciate this opportunity to comment on this consultation.

This consultation response covers the positions of our members that are clearing members and their clients. The paper does not reflect the views of many CCPs, and many of the CCPs are in disagreement with the views expressed herein.

As a matter of principle, we believe that recovery measures should be sufficient to restore the CCP to viability, without causing losses to spill over to the broader economy. Unlike most for-profit shareholders, most CCP owners bear only a small portion of the CCP's losses because the DF and recovery tools available to a CCP serve to externalize a large portion of a CCP's losses to clearing members and end users. As a result, for-profit CCP incentives have the potential to be materially misaligned.

if recovery plans are inappropriately structured, they could destabilize individual market participants and/or the financial system during a crisis scenario, by propagating stress through the market. It is critical that competent authorities review the CCP recovery plans with this in mind.

We generally agree with ESMA's proposal on the factors that shall be considered by the competent authority and the supervisory college when assessing the CCP recovery plan. This proposal is very detailed and should provide sufficient guidance to NCAs for assessing recovery plans.

Questions

Q1 : *Do you agree with the proposed list of elements (as further specified in the RTS) to be taken into consideration under point (a) of Article 10(3) of CCPRRR?*

We generally agree with the proposed list of elements to be taken into consideration under point (a) of Article 10(3) of CCPRRR.

Please find below some comments:

Overall suitability

We agree that the CCP's communication and disclosure plan is of key importance. Only if CCP clearing participants (both clearing members and their clients) know what recovery actions the CCP will likely take, clearing participants will be able to take actions that are consistent with the recovery plan. Otherwise, clearing participants will identify worst scenarios and manage on the basis of these worst-case scenarios, which could be detrimental to the CCP recovery efforts.

We also support that linked FMIs and stakeholders including clearing participants should be involved in the process of drawing-up of recovery plans.

Ownership

We agree that a CCP's ownership structure somehow affects recovery: A solvent owner with a strong interest in the clearing activities of a CCP (for instance a linked exchange) will be more likely to provide additional resources during the recovery phase. However, we note that there is no clear and binding obligation on the CCP owner to follow such an approach.

Substitutability of the CCP's activities

While we agree that the availability of other CCPs that provide some or all of the clearing services provided by the relevant CCP could be helpful to potentially facilitating options for clearing participants as to where new business is cleared, there is virtually no viable solution for the transfer of existing transactions. Substitutability of a CCP therefore should not be relied on to support a recovery phase.

Business model of the CCP

While the sale of assets or business lines might be useful for slow-burning recovery scenarios (slow degradation of the business, regulatory fines, lawsuits), the vast majority of recovery scenarios (for instance defaults, investment losses or cyber events) will occur in a timeframe much shorter than sales of assets or business lines to be facilitated.

Capital Structure

As regards the capital structure of the CCP, we recommend that the CCPs' own-funds contribution to the default waterfall should be a meaningful amount and available to cover default and non-default losses. This is critical to align incentives, particularly in the case of for-profit CCPs.

Specifically, the recovery plan should specify that the CCP is responsible for covering non-default losses, such as those arising from financial, operational or cyber risks. CCP recovery plans should specifically ensure that CCPs have the resources to cover such losses through their own funds. Allocating such losses to clearing members or clients creates a misalignment of incentives which could undermine strong risk management.

We agree with ESMA's comment on the need for the CCP to have measures in place to ensure a timely recapitalization of the CCP.

Q2 : Would you add any additional elements and/or delete any? If so, please justify.

We haven't identified any additional elements.

Q3 : Do you agree with the proposed list of elements (as further specified in the RTS) to be taken into consideration under point (b) of Article 10(3) of CCPRRR?

We generally agree with the proposed list of elements to be taken into consideration under point (a) of Article 10(3) of CCPRRR.

Please find below some comments:

Overall impact of the recovery plan on the CCP's clearing members

We agree with the elements to be considered but propose to also add the way how recovery tools affect clearing members and their clients, especially if recovery tools affect clearing participants equally, and the financial impact these recovery tools could mean for clearing participants.

When the competent authority is assessing the potential impact of the recovery plan on clearing members and end-users, it is important that they consider whether recovery tools, which draw on resources provided by clearing members or clients, are capped at a reasonable level. For example:

- A CCP should only be permitted to assess over a reasonable period, and assessment should be capped. This would limit the pro-cyclical effect of assessments, reduce performance risk of those assessments, enabling members to measure and manage their exposures and reduce the likelihood that the assessments lead to systemic risk or a liquidity crunch.
- Tools such as Partial Tear Ups and Variation Margin Gains Haircutting must similarly be limited in amount and time (e.g., no more than a day), as these measures could subject clearing members and end users to undesirable market or liquidity risk and cause procyclical effects if participants are incentivized to close out positions.

Overall impact on financial markets, including trading venues

While there can be impacts on trading venues (e.g. if executed transactions cannot be cleared right away because of operational difficulties at a CCP), trading venues will be overall less affected by recovery as other stakeholders, especially if the CCP tries to recover from financial stresses.

Overall impact on the financial system of any Member State and the Union as a whole

We agree that the ESMA cross-CCP stress testing exercises should be used. So far, stresses used in these exercises were however not severe enough to meaningfully inform recovery planning. We recommend ESMA to introduce scenarios (in addition to other scenarios) in its stress testing that are designed to trigger recovery situations to show impact of the recovery tools to the regulators and market participants.

We also recommend ESMA to leverage its work on the analysis according to article 25 (2c) of EMIR whether Tier-2 CCPs or some of their clearing services are of such substantial systemic importance that a CCP should not be recognised to provide certain clearing services or activities. The scenarios and transmission mechanisms under which Tier-2 CCPs might impact the financial system of the European Union or any Member State and as a whole will be very similar to the impact of recovery actions of a EU CCP. The crisis scenarios from ESMA's analysis should therefore form useful guidance in the appropriateness and effectiveness of recovery tools considered in the CCP's recovery plan.

Q4 : Would you add any additional elements and/or delete any? If so, please justify.

We haven't identified any additional elements.

Q5 : Do you agree with the proposed list of elements (as further specified in the RTS) to be taken into consideration under point (c) of Article 10(3) of CCPRRR?

Incentives linked to recovery actions are complex. FIA and ISDA have as part of the response to an FSB consultation produced an [incentive analysis](#), which we will provide as part of this response.

This is a complex document. We propose for ESMA to produce something similar or use our analysis to avoid that every competent authority has to duplicate this analysis.

Q6 : *Would you add any additional elements and/or delete any? If so, please justify.*

We haven't identified any additional elements.

Cost and Benefit Analysis Questions:

Q7 : *Do you agree with the Option 1, if not please explain? Have you identified other benefits and costs not mentioned above associated to the proposed approach (Option 1)?*

We do generally agree with the proposed approach and therefore also agree with option 1 in the cost-benefit analysis.

Q8 : *If you advocated for a different approach, how would it impact the cost and benefit assessment? Please provide details.*

No, we don't advocate for a different approach, while we made some proposals to add or adapt certain aspects. These proposals however will not affect the cost-benefit analysis in a significant way.

About FIA

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. Our membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from about 50 countries as well as technology vendors, law firms and other professional service providers.

Our mission: To support open, transparent and competitive markets, protect and enhance the integrity of the financial system, and promote high standards of professional conduct.

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 960 member institutions from 78 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.