Response Form to ESMA's Consultation Paper on the draft RTS on Business Reorganisation Plans (Article 37(4) and 38(4) of CCPRRR)

Please make your introductory comments below, if any

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 are supportive overall of ESMA's consultation on the draft RTS on business reorganisation plans, and welcome the opportunity to provide comments on this draft RTS.

Our members acknowledge the importance of maintaining the continuity of the critical functions and core business lines of a CCP in resolution. Business reorganisation plans play an important role in achieving this objective. As such, they should be carefully designed, in consultation with clearing members.

The Associations are concerned with the proposal to include a reference to recovery measures as part of the measures that could be adopted under the business reorganisation plan, for several reasons, set out in our response to question 2. In addition, the Associations invite ESMA to add a requirement to consider potential risks of conflicts of interest that may arise if a CCP's incumbent management develops the business reorganisation plan. Similarly, we think the plan should also include a review of the CCP's risk management framework.

The Associations would like to invite ESMA to strengthen the criteria that must be met for the plan to be approved by the competent authority, as further set out in our response to question 4. This includes considering the extent to which the plan is developed in transparency and consultation with clearing members, especially given the impact that previously applied recovery and resolution measures will have occasioned on them. We note that our above point on conflicts of interest should also be factored into authorities' assessment of the plan, as any such potential conflict would taint the credibility – and potential viability – of said plan. We would also suggest strengthening the requirement to consider potential financial stability impacts of the plan when assessing the viability of the plan.

Finally, we would suggest that authorities have regard to relevant guidance from the Financial Stability Board (FSB) when assessing the viability of the plan – and we more generally encourage ESMA to take account of any relevant policy outcome from the FSB's current work on CCP resolution.

Q1 Do you agree with how ESMA has further specified the required assessment to identify the factors and circumstances that caused the CCP to fail or to be likely to fail (please also see Article 1 of the draft RTS)? If not, please explain?

We agree with the way in which ESMA has specified the required assessment of the factors and circumstances that caused the CCP to fail or to be likely to fail. We agree that this should include an assessment of the cause – whether a default or non-default loss event or combination of both, a detailed assessment of which of the circumstances set out in Article 22(3) of CCPRRR apply, and a description of the recovery and resolution tools already used by the CCP or the resolution authority before submission of the plan.

Q2 Do you agree with how ESMA has further specified the descriptions to be provided under the business reorganisation plan related to the measures to be adopted under the plan (please see Articles 2-6 of the draft RTS)? If not, please explain?

We have four key comments on how the draft RTS currently specifies the description of the measures to be adopted under the plan:

1. Removing the reference to recovery measures

On the description of the measures to be adopted to restore the CCP's long-term viability, we do not agree with the proposal that the plan should consider measures that have been previously identified in the recovery plan, as currently set out under Article 2(1)(c) of the draft RTS – as further set out below, we see this provision as going beyond the scope of Article 37(3) of CCPRRR, and do not think that recovery measures belong in the post-resolution reorganisation phase, based on the role foreseen for business reorganisation plans in CCPRRR.

First, on form, we note that the list of measures aiming to restore the long-term viability, as set out in article 37(3) of CCPRRR, is limitative and does not include recovery measures. As such, this does not give room to add measures other than those listed under Article 37(3) with regards to restoring the long-term viability of the CCP. Therefore, the reference to "measures previously identified in the recovery plan" under Article 2(1)(c) seems to go beyond the scope of Article 37(3) of the CCPRR, and therefore should be removed from the draft RTS.

Second, on substance, we consider that recovery measures are inadequate once resolution has occurred. When a CCP reaches this stage, it effectively means that recovery measures could not restore the CCP's viability. This is evidenced by provisions set out under Article 22 of CCPRRR on conditions for resolution:

- as set out under Article 22(1), one of the three cumulative conditions for triggering a resolution action is that there is no reasonable prospect a CCP's recovery measures would prevent the failure of the CCP within a reasonable timeframe.

- Similarly, as set out under Article 22(3)(c) of CCPRRR, a CCP may be considered as failing or likely to fail (also one of the three cumulative conditions for triggering a resolution action) when it is shown that a CCP would not be able to restore its viability via the implementation of recovery measures.
- In addition, under article 22(5) of CCPRRR, the resolution authority may take resolution actions when it considers that the application of recovery measures would cause significant adverse effects to the financial system.
- The 'No Creditor Worse-Off' principle, as set out under Article 60 of CCPRRR, gives some protection to clearing members in resolution that anything above and beyond what the CCP could have drawn on in recovery would be subject to a claim. We see this as further suggesting that recovery tools should not be considered as part of the measures to restore the CCP's long term viability post-resolution, as doing so would carry implications vis-à-vis the NCWO principle.
- We also note that the resolution authority would likely have exhausted all unused recovery tools that could have helped resolution.

For all these reasons, we consider that after a CCP has been subject to resolution action, recovery measures should not be considered anymore – and should not be included for consideration in the business reorganisation plan – as they would have been shown to either be insufficient to restore the CCP's viability or would cause significant adverse effects to the system. We certainly do not support any additional loss allocation to clearing participants (clearing members or their clients) after resolution has been completed.

2. Governance/risk management considerations

We argue that every situation that leads to resolution of a CCP is – at least indirectly – a result of failures in the CCP's risk management. We therefore propose that:

- A requirement be added under Article 2 of the draft RTS to require that the business reorganisation plan always includes a review of the CCP's risk management framework, and
- Where the CCP's incumbent management might be facing a conflict of interest in designing measures to be included in the business reorganisation plan, an independent third party should be appointed to develop the plan (see our response to Question 4 on that point, which we think should also be considered as one of the viability performance criteria, as noted in our response to Question 4).

3. Consultation with members

Given the potential sizable impact of resolution on clearing members, Article 2 of the draft RTS should further specify that the measures to be adopted to restore the CCP's long-term viability need to be defined in consultation with clearing members, who should participate in any decisions related to the CCP's long-term continuation, at least in an advisory/consultative capacity. We believe this point should also be reflected in the viability performance criteria set out under Article 8 of the draft RTS (as noted in our response to Question 4).

4. Interplay with authorisation requirements

On a separate note, we would point out that where the condition set out under Article 22(3)(a) of CCPRRR applies – that is, the CCP infringes, or is likely to infringe its authorisation requirements – the RTS should further specify that the business reorganisation plan needs to set out how the CCP intends to remain authorised under regulation (EU) No 648/2012, or what steps it will take in relation to authorisation requirements with its competent authority.

Q3 Do you agree with how ESMA has further specified the timetable and the aspects to be considered in the implementation of the business reorganisation plan (please see Article 7 of the draft RTS)? If not, please explain?

We agree with the specification of the timetable and aspects to be considered in the implementation of the business reorganisation plan, subject to two comments:

- As noted in our response to Question 2, consideration should also be given in the timetable to authorisation requirements, and how the CCP intends to restore compliance with those requirements, where the circumstances that caused the CCP to fail or to be likely to fail include an infringement or likely infringement of its authorisation requirements.
- We note that the RTS requires that the timetable include a description of the timeline for communication to the public and relevant external stakeholders – in that regard, we suggest specifying that this should also include a timeline for communication with clearing participants.

Q4 Do you agree with how ESMA has further specified the criteria to be fulfilled for the approval of the business reorganisation plan under this draft RTS (please see Articles 8-13 of the draft RTS). If not, please explain?

We broadly agree with how ESMA has specified the criteria to be fulfilled for approval of the business reorganisation plan, but would have one observation and three comments on these.

First, we would stress the importance of ensuring that when considering the viability and financial performance of the plan, resolution authorities have regard to the FSB guidance on CCP resolution and resolution planning (July 2017) and the FSB guidance on financial resources to support CCP resolution November 2020). We see the outcome of the assessment of resolution costs (under Section 3 of the 2020 guidance) and the interaction of any additional financial resource requirement with recovery and business-as-usual impact on the CCP as relevant when considering the viability of a business reorganisation plan. As FSB's current work on CCP resolution progresses, we would also advise that authorities be encouraged to consider the policy outcomes of that work. We suggest that these points be reflected in the recitals introducing the draft RTS.

Then, we have three comments on the current drafting, regarding: ensuring appropriate consultation and transparency with clearing members on the measures included in the plan; considering potential conflict of interests; and demonstrating the financial stability impact of the plan:

- ***On consultation and transparency with clearing members***: we suggest that the viability performance criteria listed under draft RTS Article 8 also include a requirement that the plan be elaborated in consultation with clearing members, who should be able to participate in any decisions related to the CCP's long-term continuation, at least in an advisory/consultative capacity.
- ***On conflicts of interest***: due consideration should also be paid to potential conflicts of interest if the business reorganisation plan is proposed by the management of the CCP: Article 37 of CCPRRR, as further elaborated in Article 8(1)(g) of the draft RTS, explicitly lists changes to the CCP's risk management are as one of the measures that can be included in a business reorganisation plan. This potentially creates a conflict of interest at inception if the CCP's own management develops the plan, as they would not have any real incentive to consider measures to change the CCP's management. Therefore, where draft RTS Article 8(1)(g) applies – that is, the resolution shall be accompanied by the replacement of management, the draft RTS should further specify that a third party should be appointed, to consider any measure where the CCP's management would appear to face a conflict of interest.
- ***On the financial stability impact of the plan***: we suggest strengthening the language on the impact of the measures set out in the plan on market participants. We note that one of the viability performance criteria set out under Article 8 (1) is that "to the best knowledge of the CCP", the measures set out in the plan would not have a negative material effect on market and financial stability (criteria (h)). We suggest strengthening the language for that criterion, for example requiring that the plan includes a detailed analysis of the potential impact of the implementation of the measures on market participants, to support the CCP's demonstration that the plan would not have a material negative effect on market and financial stability.

Cost-benefit analysis

PART I - options on how to specify further the minimum elements under Article 37(2) of CCPRRR

Q5 Do you agree with the Option 2, if not please explain? Have you identified other benefits and costs not mentioned above associated to the proposed approach (Option 2)?

We agree with Option 2, i.e. providing requirements on how a CCP shall design the measures to be adopted in the business reorganisation plan, and aspects to be considered when establishing the plan, rather than providing detailed measures to be included in a plan, as suggested in Option 1. We agree with the assessment of the benefits of Option 2, and do not see any costs of Option 2 relative to Option 1.

Q6 If you advocated for a different approach, how would it impact the cost and benefit assessment? Please provide details.

Not applicable.

PART II - options on how to specify the criteria under Article 38 of CCPRRR that a business reorganisation plan should fulfil for approval by the resolution authority

Q7 Do you agree with the Option 2, if not please explain? Have you identified other benefits and costs not mentioned above associated to the proposed approach (Option 2)?

We agree with Option 2, i.e. specifying in the draft RTS the criteria that a business reorganisation plan should fulfil, rather than just providing high-level requirements that the plan should fulfil, as suggested in Option 1. We agree with the benefits and costs associated with Option 2.

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

Not applicable.

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.

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 79 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.