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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union

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Subject:	COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT pursuant to Article 294(6) of the Treaty on the Functioning of the European Union concerning the position of the Council on the adoption of 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
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Delegations will find attached document COM(2020) 694 final.

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Brussels, 18.11.2020
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2016/0365 (COD)

**COMMUNICATION FROM THE COMMISSION
TO THE EUROPEAN PARLIAMENT**

pursuant to Article 294(6) of the Treaty on the Functioning of the European Union

concerning the

**position of the Council on the adoption of a Regulation of the European Parliament and
of the Council on a framework for the recovery and resolution of central counterparties
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1. BACKGROUND

Date of transmission of the proposal to the European Parliament and to the Council (document COM/2016/0856 final – 2016/0365 COD):	28 November 2016
Date of the opinion of the European Economic and Social Committee:	29 March 2017
Date of the opinion of the European Central Bank:	20 September 2017
Date of the position of the European Parliament, first reading:	27 March 2019
Date of transmission of the amended proposal:	N/A
Date of adoption of the position of the Council:	17 November 2020

2. OBJECTIVE OF THE PROPOSAL FROM THE COMMISSION

A central clearing counterparty (CCP) is a financial markets infrastructure that acts as the counterparty to both sides of a transaction in a financial instrument. CCPs clear a range of financial instruments. They are essential to the financial system because they manage significant amounts of counterparty risk. In doing that, they create links between multiple banks, other financial counterparties and corporates (the clearing participants¹).

The number of transactions processed by CCPs has increased since the 2009 G20 commitment to have standardised over-the-counter (OTC) derivatives cleared through CCPs.

The failure of a CCP is very unlikely but would have a considerable impact on financial stability. To address the potential risks if a CCP were to fail, the Commission adopted a legislative proposal on CCP recovery and resolution on 28 November 2016². It builds on the

¹ The term “clearing participants” means “clearing members” and “clients”. In EMIR, “clearing member” means an undertaking which participates in a CCP and which is responsible for discharging the financial obligations arising from that participation and ‘client’ means an undertaking with a contractual relationship with a clearing member of a CCP which enables that undertaking to clear its transactions with that CCP.

² 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.

European Market Infrastructure Regulation³ (EMIR) and is based on the conceptual framework of the BRRD⁴ (Bank Recovery and Resolution Directive). It will transpose into EU law the international standards set by the Financial Stability Board's Key Attributes⁵ and Guidance⁶ that the EU committed to in the G20 framework.

The aim of the proposal is to ensure that both CCPs and national authorities in the EU are prepared and have the tools to act decisively in a crisis scenario. The proposed Regulation is built on three pillars: preparedness (recovery and resolution plans, powers to improve resolvability), early intervention powers, and a harmonised resolution toolkit for national resolution authorities. The new rules will ensure that CCPs' critical functions are preserved while maintaining financial stability and helping to avoid that the costs of resolving failing CCPs fall on taxpayers.

3. COMMENTS ON THE POSITION OF THE COUNCIL

The position of the Council reflects the political agreement reached between the European Parliament and the Council on 23 June 2020. The Commission supports this agreement.

The political agreement introduced several changes that deviate from the initial Commission proposal, including on the following points:

A. Governance

i. Resolution college membership

The political agreement confirms the composition of the resolution college based on an extension of the composition of the existing supervisory college, but takes into account the modifications incorporated through the review of EMIR in October 2019⁷.

The resolution college therefore includes, as voting members, not only the members of the revised EMIR supervisory college, the resolution authorities of the CCP and of any interoperable CCPs and the resolution authorities of the CCP's clearing members from the three Member States that have the largest contributions to its default fund but also, as observers:

- the competent and resolution authorities of other clearing members;
- the competent or resolution authorities of clients from any Member State that is not already represented by a college member;

³ 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.

⁴ 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.

⁵ Key Attributes of Effective Resolution Regimes for Financial Institutions, 15 October 2014.

⁶ https://www.fsb.org/wp-content/uploads/r_141015.pdf

⁷ Guidance on Central Counterparty Resolution and Resolution Planning, 5 July 2017.

<https://www.fsb.org/wp-content/uploads/P050717-1.pdf>

⁷ Regulation (EU) 2019/2099 of the European Parliament and of the Council of 23 October 2019 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.

- other central banks of issue; and,
- the competent authority of the parent undertaking, where applicable.

In the three first cases, the request to participate in the resolution college should be justified by the systemic effects of the CCP's failure in their respective Member States and on their currencies of issue.

This extended composition aims at fostering cooperation and information sharing among authorities and at ensuring that the interests of a larger number of potentially affected stakeholders are taken into account in the resolution planning.

ii. Ex-ante information

The political agreement envisages that resolution authorities notify ex ante the resolution college of the resolution actions they intend to take and whether the resolution action deviates from the resolution plan. An ex post notification completes the framework to provide the reasons for any deviation to the resolution college as soon as practicable after taking the resolution action.

This notification process aims to be a pivotal element of transparency for the decision-making framework, enabling the authorities of the concerned Member States to assess and anticipate the effects of a CCP's resolution.

iii. ESMA binding mediation on recovery plans, resolution plans, and resolvability measures

As proposed, most decisions of the national competent and resolution authorities in relation to the preparatory phases are subject to a joint decision by the voting members of the supervisory and resolution colleges. Such joint decision should be reached within a four-month period. Absent such common decision, the respective home authorities of the CCP could decide on their own, unless ESMA binding mediation is called upon.

The political agreement sets the threshold for calling upon ESMA binding mediation for issues related to recovery and resolution planning to a simple majority of the supervisory or resolution college.

This is found to be a balance between allowing any college member to submit such request to ESMA, following for instance the mechanism of the BRRD, and requiring a two-third majority of the voting college members, as is the case in EMIR. It should allow the respective colleges to work effectively, aiming at taking decisions in the preparation phase that reflect the interest of their members, while benefitting from the mediation mechanism in the most difficult cases.

iv. ESMA mandates

The political agreement requires ESMA to develop Regulatory Technical Standards to specify:

- the content of the written arrangements and procedures for the functioning of the resolution colleges;

- the methodology for calculation and maintenance of the amount of the additional prefunded dedicated own resources to be used by the CCP in recovery as well as the procedures, in case such own resources are not available, for the CCP to require contributions of non-defaulting clearing members and to subsequently reimburse such clearing members;
- the assessment methodology for recovery plans;
- the contents of resolution plans;
- the order of allocation, maximum period and maximum share of the CCP's annual profits under the recompense mechanism in recovery;
- the elements relevant to the conduct of valuations;
- the methodology for calculating the buffer for additional losses to be included in provisional valuations;
- the minimum elements that should be included in a business reorganisation; criteria that a business reorganisation plan is to fulfil;
- the methodology for final valuation under the no-credit-worse-off principle;
- the conditions for clearing members to pass on compensation to their clients in line with the contractual symmetry principle.

It also requires ESMA to develop guidelines setting out or promoting:

- the minimum list of qualitative and quantitative indicators for triggering recovery measures;
- the range of scenarios to be considered for the recovery plan;
- the convergence of resolution practices regarding the resolvability assessment;
- the consistent application of the triggers for the use of the early intervention measures;
- the convergence of supervisory and resolution practices regarding the application of the circumstances under which a CCP is deemed to be failing or likely to fail;
- the methodology to be used by the resolution authority for determining the valuation of contracts to be terminated;
- the types and content of the provisions contained in cooperation arrangements with third countries;
- the circumstances in which the competent authority may request the CCP to refrain from certain payout operations following a non-default event.

B. Early intervention, recovery plans and tools

i. Additional skin-in-the-game (SITG)

EMIR introduced a layer of CCP's own resources in the loss allocation mechanisms of CCPs, that is to be used just before the non-defaulting clearing members' contributions to the default fund. This first SITG is set at 25% of a CCP's capital requirements and aims at ensuring that the owners and shareholders of a CCP exercise an appropriate oversight on its activities and risk management practices.

The political agreement introduces an additional layer of CCP's own resources, i.e. a second SITG, prior to the application by the CCP of any cash call or variation margins gains haircutting (VMGH) in recovery. This second SITG is set between 10%⁸ and 25% of a CCP's risk-based capital requirements as mandated under EMIR. The methodology for calculating the second SITG as well as the conditions for maintaining it will be specified in a Commission delegated act based on a Regulatory Technical Standard developed by ESMA, taking into account:

- the structure and internal organisation of CCPs and the nature/scope/complexity of their activities;
- the structure of incentives of CCP's shareholders, management, clearing members and clients;
- the appropriateness for CCPs, depending on the currencies in which the financial instruments they clear are denominated, the currencies accepted as collateral and the risk stemming from their activities, to benefit from a broader investment policy;
- the international context and the practices in other jurisdictions.

A broader investment policy, granted in accordance with the conditions that will be developed by ESMA in the regulatory technical standard, may entail additional liquidity risks. Therefore, in the event that the assets in which the second SITG has been invested are not immediately available to absorb losses, the political agreement allows CCPs to proceed with their allocation to clearing members as set out in their recovery plans in order to guarantee the continuity of the critical clearing services. CCPs will have to subsequently reimburse the clearing members up to the amount of the second SITG.

ii. Variation Margins Gains Haircutting (VMGH) and cash calls in recovery

The political agreement foresees the use of VMGH, where relevant depending on the CCP's activities, and cash calls in recovery. This reflects the current practice of most CCPs and aims at improving the protection of taxpayers. In parallel, the political agreement is reinforcing the transparency of the recovery measures for stakeholders as well as their involvement in the development of the recovery plans. It is also further framing the use of recovery measures by introducing several elements of monitoring and control by the competent authorities.

iii. Other: Participation of clients in auctions; restriction of remunerations

The political agreement includes an early intervention power that allows the competent authority to broaden the scope of auctions to clients and enable them to make bids for the defaulting clearing member's positions. The competent authority would require the CCP to instruct clearing members to invite their clients to participate directly in auctions organised by the CCP. This possibility is subject to the conditions that the nature of the auction justifies this exceptional participation and that the client is able to demonstrate to the CCP that it has set up the appropriate contractual relationship with a clearing member to execute and clear the transactions that may result from the auction.

⁸ The notification threshold, as set out in Article 1(3) of the Commission Delegated Regulation (EU) No 152/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on capital requirements for central counterparties, can be used to meet all or part of the second SITG requirement.

Competent authorities are also empowered to restrict or prohibit any remuneration of equity, including dividend payments and buybacks by the CCP, and to restrict, prohibit or freeze any payments of variable remuneration to senior management.

C. Resolution tools

i. Resolution cash calls

The political agreement confirms a resolution cash call reserved for the resolution authorities in addition to the cash calls foreseen in the CCP's recovery measures. The maximum exposure of clearing members due to their additional financial commitment is increased to two times their contributions to the CCP's default fund. This approach remains consistent with EMIR (Article 43(3)) that requires that clearing members of a CCP have limited exposures towards the CCP. The political agreement also clarifies the use of the resolution cash call in case of non-default events as well as the determination of the cap when CCPs have multiple default funds.

ii. Initial Margin Haircutting (IMH)

The political agreement opts for a closed list of resolution tools and explicitly excludes the use of IMH. This approach is found consistent with EMIR (Article 45 (4)) that specifies that a CCP shall not use the margins posted by non-defaulting clearing members to cover the losses resulting from the default of another clearing member. It also facilitates the enforcement of resolution actions in major third-country jurisdictions where initial margins are explicitly excluded from the insolvency procedure in application of the local rules and regulations.

D. No Creditor Worse Off than in liquidation (NCWO) safeguard

The NCWO safeguard is aimed at protecting the fundamental rights of CCPs' shareholders, clearing members and other creditors in resolution.

In line with international guidance set out by the Financial Stability Board, the political agreement compares the losses incurred by CCP's shareholders, clearing members and other creditors in resolution with the losses they would have realistically incurred if the CCP had been wound up under normal insolvency proceedings, following the full application of the applicable contractual obligations and other arrangements in its operating rules.

In terms of valuation, the political agreement requires that the NCWO counterfactual takes into account a commercially reasonable estimate of the direct replacement costs incurred by clearing members to reopen comparable net positions in the market. It also requires the use of the CCP's own pricing methodology to estimate such losses unless such methodology for price determination does not reflect the effective market conditions.

The political agreement also introduces a notion of "contractual symmetry" that extends the protection of the NCWO safeguard to clients. It stipulates that if contractual arrangements allow clearing members to pass on the negative consequences of the resolution tools to their clients, then contractual arrangements shall also have to include, on an equivalent and proportionate basis, the right of clients to any compensation clearing members receive to the extent that these refer to client positions. This provision also applies to indirect clearing services.

E. Compensation of non-defaulting clearing members

The political agreement confirms the possibility for a resolution authority to require the CCP to compensate non-defaulting clearing members for their losses stemming from the application of loss allocation tools, where the losses are in excess of those that the non-defaulting clearing members would have borne in accordance with the CCP's operating rules.

This compensation would be limited to cases where the non-defaulting clearing member would have been entitled to a no creditor worse off (NCWO) claim.

It can take the form of instruments of ownership, debt instruments or instruments recognising a claim on the CCP's future profits.

In order to incentivise clearing members to support the recovery process, the compensation mechanism takes account of any outstanding contractual obligations of the clearing members toward the CCP.

The compensation will be deducted from any NCWO claim due to clearing members, thereby reducing considerations Member States would have to pay to clearing members should those have contributed more to resolution than they would have lost in insolvency.

F. Recoupment of public funds

Several conditions are added by the political agreement for the use of the government stabilisation tools in the form of equity support and temporary public ownership. One important condition relates to the write down and conversion by the resolution authority of any remaining instruments of ownership, debt instruments or other unsecured liabilities before or together with the use of the government stabilisation tools. Member States should also have defined, in advance of the use of the government stabilisation tools, comprehensive and credible arrangements for the recoupment of public funds over a suitable period of time.

The political agreement mandates the recoupment of any public funds used as government stabilisation tools as well as any reasonable expenses incurred by the resolution authority in connection with the use of resolution tools or powers. This includes the expenses related to possible NCWO claims.

The political agreement also enumerates the main sources of recoupment.

Finally, to complement these sources, the political agreement introduces a mechanism of “delayed enforcement” of any remaining contractual obligations from stakeholders vis-à-vis the CCP, in particular clearing members or parent undertakings, that would not have been enforced during a resolution process that involved the use of public funds. Such partial enforcement is allowed by the political agreement in situations where:

- the full application of the outstanding contractual obligations is not possible within a reasonable timeframe;
- the full application of the outstanding contractual obligations would create significant adverse effects on the financial system or foster contagion; or,
- the application of the resolution tools would be more appropriate to achieve the resolution objectives in a timely manner.

The resolution authority would have the possibility to still enforce those remaining contractual obligations to recover the use of public funds up to 18 months after the CCP is considered to be failing or likely to fail if the reasons for refraining from enforcing these obligations no longer exist.

G. Treatment of CCPs as part of groups

The political agreement removes the possibility of group recovery plans but strengthens the requirement for authorities to consider group interdependencies in the context of assessing or designing recovery and resolution plans. In particular, the political agreement requires CCPs to develop recovery scenarios in which the financial support eventually agreed with their groups or parent undertakings would not be available.

H. Amendments of EMIR and other acts

The political agreement introduces several amendments to existing legislative acts. The most significant ones are the following.

i. Suspension of the clearing obligation

Consistent with EMIR Refit⁹, the political agreement modifies EMIR to allow not only the suspension of the clearing but also of the trading obligations in cases of resolution.

ii. Interest rates benchmarks

The political agreement introduces an amendment to EMIR to provide an exemption from the clearing obligation or the margin requirements to legacy trades if these trades were to be novated for the sole purpose of implementing or preparing for the implementation of the Financial Stability Board's interest rate benchmark reform¹⁰.

This amendment implements an international agreement reached by the Financial Stability Board, the Basel Committee on Banking Supervision and the International Organisation of Securities Commissions recommending to provide such a relief.

iii. Open access

The political agreement retroactively postpones by one year the open access provisions of the Markets in Financial Instruments Regulation (MiFIR)¹¹.

MiFIR introduces a non-discriminatory open access regime to trading venues and CCPs for exchange-traded derivatives (ETDs). The key purpose of the open access requirement is to break “the vertical silo” between trading and clearing infrastructures and facilitate competition. Very importantly, MiFIR open access rules also added multiple temporary

⁹ Regulation (EU) 2019/834 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories.

¹⁰ <https://www.fsb.org/work-of-the-fsb/policy-development/additional-policy-areas/financial-benchmarks/>

¹¹ Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

transition periods and opt-outs amounting to an exemption from the application of access rights. All in all, Article 54(2) of MiFIR provides national competent authorities (NCAs) with the possibility to temporarily exempt trading venues and CCPs from the MiFIR access provisions for ETDs. The 30-month transition period in that article has been used and would have ended on 3 July 2020.

Such postponement should be considered in the perspective of the effects for financial markets of the current pandemic crisis. On 11 June, ESMA issued a public statement to clarify the application of the MiFIR open access provisions in light of the recent adverse developments related to COVID-19. It also aimed to coordinate the supervisory actions of national competent authorities by setting out the issues they should consider when assessing open access requests. ESMA considers that the current market environment, with a high degree of uncertainty and volatility driven by the COVID-19 pandemic, may negatively impact CCPs and trading venues operations and increase their operational risk. These increased risks, combined with limited capacity for assessing access requests and for managing the migration of transactions flows, may impact the orderly functioning of markets or financial stability. ESMA expects national competent authorities to take into consideration, to the extent relevant, the relevant adverse developments when taking decisions on open access requests. The political agreement provides a motivation for the postponement in the recitals of the legislative act, both regarding the adverse effects arising from the COVID situation, as well as the way in which the legitimate expectation of market operators have been taken into account.

In this context, the Commission takes note of the fact that the political agreement has included provisions relative to the open access requirements under articles 35 and 36 of the MiFIR. These provisions were not included in the initial proposal of the Commission. In the Commission's view, these provisions are not entirely in line with the EU's institutional set-up, in particular the Commission's right of initiative, and cannot constitute a precedent for future negotiations.

As the MiFIR changes at issue do not entail a substantive change of policy, but are rather limited to a short postponement of the MiFIR access provisions, the Commission will not now stand in the way of their adoption. This is without prejudice to any policy that the Commission may propose on this issue in the future.

I. Final provisions, entry into application and review clause

The political agreement introduces the following review clauses:

- By 31 December 2021: a review of the application of the write down and conversion tool in the event of resolution of CCPs in combination with other resolution tools that result in financial losses being borne by clearing members. This review clause is aimed at taking into account possible progress at the level of the Financial Stability Board on the treatment of CCPs' equity in resolution.
- After 5 years: a general review of the legislation, in particular “the appropriateness and sufficiency of financial resources available to the resolution authority to cover losses arising from a non-default event; (b) the amount of own resources of the CCP to be used in recovery and in resolution and the means for its use; (c) whether the resolution tools available to the resolution authority are adequate”.

- After 6,5 years: a review of the governance arrangements for the recovery and resolution of CCPs in the Union.

Finally, the political agreement foresees a phased entry into application to take account of the deadlines set for ESMA to develop technical standards and guidelines, whereby:

- Provisions on recovery plans, their assessments and the related decision-making process will be applicable after 12 months;
- All provisions related to the resolution of CCPs will be applicable after 18 months; and,
- Provisions setting out the second SITG and a recompense mechanism for the use of Variation Margin Gains Haircutting for non-default losses in recovery will be applicable after 24 months.

5. CONCLUSION

The Commission supports the results of the interinstitutional negotiations and can therefore accept the Council's position at first reading. However, it expresses its institutional concerns expressed in section H., point (iii).