

Guidelines

On the application of the circumstances under which a central counterparty is deemed to be failing or likely to fail (Article 22(6) of CCPRRR)



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I. Scope of Guidelines

Who?

These Guidelines will apply to competent authorities, as defined in Article 22 of EMIR, and to resolution authorities, as defined in Article 2(3) of CCPRRR, when they determine whether a central counterparty is failing or likely to fail.

What?

Guidelines 1-7 apply in relation to Article 22(3) of CCPRRR. Guidelines 8 and 9 apply in relation to Article 22(1)(a) of CCPRRR.

When?

These Guidelines apply from two months after the date of publication on ESMA's website in the official languages of the European Union.

II. Legislative references and abbreviations

For the purposes of these Guidelines the term ‘relevant authorities’ will be used in lieu of ‘the competent authority and/or the resolution authority’.

Legislative references

CCP Recovery and Resolution Regulation (CCPRRR)	Regulation (EU) 2021/23 of the European Parliament and of the Council of 16 December 2020 on a framework for the recovery and resolution of central counterparties and amending Regulations (EU) No 1095/2010, (EU) No 648/2012, (EU) No 600/2014, (EU) No 806/2014 and (EU) 2015/2365 and Directives 2002/47/EC, 2004/25/EC, 2007/36/EC, 2014/59/EU and (EU) 2017/1132 ¹
EMIR	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 ²
ESMA Regulation	Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC ³
Directive 2014/59/EU	Directive 2014/59/EU of the European Parliament and 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
RTS 153/2013	Commission Delegated regulation (EU) No 153/2013 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 requirements for central counterparties ⁴

¹ OJ L 22, 22.1.2021, p. 1–102

² OJ L 201, 27.7.2012, p. 1

³ OJ L 331, 15.12.2010, p. 84

⁴ OJ L 52, 23.2.2013, p. 41

Guidelines EBA FOLTF

Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail under Article 32(6) of Directive 2014/59/EU

Abbreviations

<i>EU</i>	European Union
<i>ESMA</i>	European Securities and Markets Authority
<i>CCP</i>	Central Counterparty
<i>ESFS</i>	European System of Financial Supervision

III. Purpose

1. These Guidelines are based on Article 22(6) of CCPRRR except for Guidelines 8 and 9 which are based on Article 16(1) of ESMA Regulation. The objective of these Guidelines is to promote 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.
2. These Guidelines clarify the different circumstances under which a CCP is deemed to be failing or likely to fail, one of the three cumulative conditions set out in Article 22(1) of CCPRRR for triggering a resolution action. In particular, they aim to promote the convergence of supervisory and resolution practices with respect to how and when resolution should be triggered with respect to the circumstances under which a CCP is deemed to be failing or likely to fail. For this purpose, these Guidelines list a set of objective elements that should support the determination that a CCP is failing or likely to fail, in accordance with the circumstances laid down in Article 22(3) of CCPRRR.
3. Given the need to provide guidance on the consultation and information exchange between the competent authority and the resolution authority for the purpose of making a determination if a CCP is failing or likely to fail, the scope of the final Guidelines is expanded beyond the scope set forth by Article 22(6) of CCPRRR. Thus, ESMA has decided to issue Guidelines 8 and 9 in accordance with Article 16(1) of ESMA Regulation in line with which ESMA may issue guidelines with a view to establishing consistent, efficient and effective supervisory practices within the ESFS, and to ensuring the common, uniform and consistent application of Union law.

IV. Compliance and reporting obligations

Status of the Guidelines

4. In accordance with Article 16(3) of the ESMA Regulation, competent authorities and resolution authorities must make every effort to comply with these Guidelines.
5. Competent authorities and resolution authorities to which these Guidelines apply should comply by incorporating them into their national legal and/or supervisory and resolution frameworks as appropriate.

Reporting requirements

6. Within two months of the date of publication of the Guidelines on ESMA's website in all EU official languages, competent authorities and resolution authorities to which these Guidelines apply must notify ESMA whether they (i) comply, (ii) do not comply, but intend to comply, or (iii) do not comply and do not intend to comply with the Guidelines.
7. In case of non-compliance, competent authorities and resolution authorities must also notify ESMA within two months of the date of publication of the Guidelines on ESMA's website in all EU official languages of their reasons for not complying with the Guidelines.
8. A template for notifications is available on ESMA's website. Once the template has been filled in, it shall be transmitted to ESMA.

V. Guidelines

Guidelines 1-2 provide general considerations that should apply in the process of determining whether a CCP is to be deemed failing or likely to fail as described in Guidelines 3-7.

Guideline 3 provides guidance on the application of Article 22(3)(c) of CCPRRR in determining if a CCP is unable or is likely to be unable to restore its viability through the implementation of its recovery measures.

Guidelines 4 and 5 both provide guidance on the application of Article 22(3)(a) and (d) of CCPRRR. They however refer to different types of financial resources of the CCP. Guideline 4 lists objective elements to be assessed with respect to the stock of available financial resources at the CCP. Guideline 5 focuses on the forecasted flows of liquid resources that will impact the liquidity risk profile of the CCP and the level of liquid resources available to the CCP.

Guideline 6 provides guidance on the application of Article 22(3)(b) of CCPRRR in determining if a CCP is unable, or is likely to be unable, to provide a critical function.

Guideline 7 provides guidance on the application of Article 22(3)(a) of CCPRRR in determining if the CCP infringes, or is likely to infringe, its authorisation requirements in a way that would justify the withdrawal of its authorisation pursuant to Article 20 of EMIR.

In order to facilitate the timely flow of information for the purpose of determining whether a CCP is failing or likely to fail, the competent authority and the resolution authority should assist each other by applying Guidelines 8 and 9. Hence, Guidelines 8 and 9 clarify the provision of information and exchange of information between the competent authority and the resolution authority in the process of determining whether a CCP is failing or likely to fail.

Guideline 1 Objective elements for determination that a CCP is failing or likely to fail

Guideline 1 provides general guidance on the considerations to be assessed in the process of determining if a CCP failing or likely to fail under Guidelines 3-7 by the relevant authority.

Guideline 1

For the purpose of making a determination that a CCP is failing or likely to fail, in accordance with the circumstances laid down in Article 22(3)(a)-(e) of CCPRRR the relevant authorities should assess the available objective elements relating to each of the following areas which application is further clarified in these Guidelines:

- a) the ability of the CCP to restore its viability through implementation of the CCP's recovery tools;
- b) the pre-funded and committed financial resources still available to the CCP;
- c) the liquid resources and liquidity arrangements still available to the CCP;
- d) the operational capacity of the CCP; and
- e) other requirements for continuing authorisation.

Guideline 2 Comprehensive analysis

Guideline 2 provides guidance on the general considerations to be assessed in the process of determining if a CCP failing or likely to fail under Guidelines 3-7 by the relevant authority.

Guideline 2

The relevant authorities should, decide whether the CCP is failing or likely to fail on the basis of a comprehensive assessment of both qualitative and quantitative objective elements listed in these Guidelines, taking into account all circumstances and information available at such time and to the extent relevant for the CCP.

The determination that a CCP is failing or likely to fail should remain an expert judgement and should not be automatically derived from any of the objective elements alone.

Furthermore, the set of objective elements listed in these Guidelines does not prevent the relevant authorities from taking into account other considerations signalling that a CCP is failing or likely to fail.

Typical circumstances which may result in the failure of the CCP include:

- a) the inability of the CCP to manage the default of one or more clearing members (i.e. default events);
- b) the inability of the CCP to address a non-default event resulting in unmanageable losses for the CCP. A large range of events could lead to non-default losses (i.e. non-default events), such as those related to:
 - (i) the failure of, or loss of access to, one or more non-clearing counterparties, such as liquidity providers, settlement banks or platforms, custodians, investment agents, concentration banks or service providers;

- (ii) custodial risk;
- (iii) settlement risk;
- (iv) investment risk;
- (v) operational risk events (e.g. IT failures, fraud, cyber-attacks, mistakes in margin calls, erroneous booking of an investment trade);
- (vi) legal risk.

These events could occur in isolation or jointly and the recovery tools and resources available to the CCP to manage these events could differ.

Guideline 3 on availability and adequacy of the CCP's recovery measures - a determination under Article 22(3)(c) of CCPRRR

Guideline 3

When determining whether the CCP is unable, or is likely to be unable to restore its viability through the implementation of its recovery measures, the relevant authorities should base their determination on objective elements including:

- a) the recovery measures that have been exercised by the CCP and their success in bringing the CCP closer to a matched book, restoring its financial position, addressing or allocating losses or covering liquidity shortfalls;
- b) the recovery measures that are still available to the CCP and the ability of the CCP to exercise them, including the CCP's legal powers and operational capacity to do so;
- c) the availability of credit facilities provided by a Central Bank;
- d) the ability of stakeholders who are called to bear losses account taken of all of the following aspects:
 - (i) to incur costs or contribute to cover liquidity shortfalls when the recovery plan is implemented;
 - (ii) to continue participating in the CCP's recovery according to their contractual obligations; and

- (iii) the potential financial stability risks related to the potential inability of these stakeholders to bear the losses and costs, to the extent the information is available.

Considering that this assessment will be undertaken in a situation of market stress, within a time limit and based on the information available at this point in time, it is important that the competent authority and the resolution authority pre-assesses those aspects by, in particular, identifying stakeholders who are called to bear losses and identifies thresholds or other indicators such as capital ratios and liquidity status that can be applied swiftly to assess such stakeholder's ability to contribute.

Guideline 4 Pre-funded and committed financial resources available to the CCP - a determination under Article 22(3)(a) and (d) of CCPRRR

Guideline 4

When determining whether a CCP is unable or likely to be unable to pay its debts or other liabilities as they fall due, the relevant authorities should assess the pre-funded and committed financial resources available to the CCP and base this assessment on objective elements, including:

- a) the amount of both pre-funded and separately committed financial resources available to the CCP to undertake recovery in each case to the extent they meet the financial resources requirements imposed on the CCP in accordance with Article 43 of EMIR and as further specified by Article 35 of RTS 153/2013;
- b) whether the CCP has the ability to convert between collateral asset classes as necessary to meet its related obligations or to realise the value of the collateral it holds;
- c) whether a major litigation or disputes to which the CCP is a party, could negatively affect the financial position of the CCP impeding its ability to pay its debt and other liabilities and to perform its critical functions;
- d) in relation to committed financial resources, the ability of the parties agreeing to provide committed financial resources (such as clearing members, the parent company, shareholders or liquidity providers) to actually transfer the committed amounts to the CCP within the timeframe required in line with the conditions agreed by such parties;
- e) in relation to its pre-funded financial resources (CCP's own contributions and/or contributions of its clearing members), the ability of the CCP to replenish them within a reasonable time frame to a level that can deliver

continuity of critical functions and to meet compliance with regulatory requirements;

- f) where the prevailing circumstances of the CCP involve a default event, indicators that the CCP could only return to a matched book by actions that would require resources in excess of its available pre-funded and committed financial resources;
- g) where the prevailing circumstances of the CCP involve a default event and/or a non-default event, the sufficiency of the pre-funded and committed resources to meet the realised and expected losses and, if necessary, to recapitalise the CCP; and
- h) where the prevailing circumstances of the CCP involve a non-default event, the sufficiency of its capital and the willingness and ability of the committed parties to absorb the realised and expected losses or recapitalise the CCP following the loss event.

The objective elements to assess with respect to the pre-funded and committed financial resources will depend on the content of the recovery plan, which may vary from one CCP to another.

Guideline 5 Liquid resources and liquidity arrangements available to the CCP - a determination under Article 22(3)(a) and (d) of CCPRRR

Guideline 5

The relevant authorities should determine, according to the CCP's operating rules and considering the relevant market conditions, whether the CCP is likely to meet its obligations in all relevant currencies as they fall due and/or is able to have recourse to its usual liquidity tools.

This assessment should be based on objective elements, including amongst others, significant adverse developments affecting the available liquidity risk profile and the liquid resources of the CCP, and the CCP's compliance with the minimum requirements for liquidity laid down in Article 44 of EMIR, as further specified by Article 32 of RTS 153/2013.

The relevant authorities should base their assessment on the following objective elements where relevant:

- a) forecasted contractual inflows arising from payments due to the CCP, both in relation to cleared positions and other business activities;

- b) forecasted outflows arising from payments due from the CCP, including withdrawals of collateral and settlement obligations;
- c) liquid resources available to the CCP and its ability to convert between asset classes and currencies as necessary to meet its obligations;
- d) liquidity lines or other arrangements available to the CCP and the certainty of these arrangements in the prevailing market and economic conditions.

The liquidity tools to be considered could for instance include foreign exchange arrangements and full market access (i.e. the ability to buy and/or sell securities immediately or to make use of repos and reverse repos).

Guideline 6 on operational capacity of a CCP – a determination under Article 22(3)(b) of CCPRRR

Guideline 6

The relevant authorities should determine whether the CCP is unable, or is likely to be unable, to provide a critical function by assessing the circumstances and events which could negatively impact the CCP's operational capacity to continue providing critical functions, without infringing financial resources and liquidity arrangements.

The relevant authority should base this assessment on objective elements, including amongst others:

- a) the CCP's inability to fulfil its obligations towards its clearing members, including to call, receive or transfer back collateral, and/or to undertake recovery measures, due to material and persistent operational constraints;
- b) the CCP's inability to recover from an operational event (such as a cyber-attack) or to address severe operational constraints in a timely manner;
- c) a significant decrease in transactions submitted for clearing or significant reduction in clearing members due to a loss of confidence in the CCP including the CCP's ability to manage risks, operationally and/or financially and this decrease in cleared transactions or reduction in clearing members threatens the CCP's viability;
- d) an evidenced intention of liquidity providers to decrease the amount of the CCP's liquid resources which would threaten the CCP's operational viability; and

- e) the CCP's inability to address severe operational constraints in a timely manner, including where the business continuity plans prove not to be adequate to restore the CCP's operations.

In the context of fulfilling its obligations towards its participants, including calling, receiving or transferring back collateral, the CCP's operational constraints may arise from the failure of systems, the failure or loss of access to settlement banks, a cyber-attack or an event that means the CCP lacks available or sufficiently experienced operational staff and an event which could negatively impact the CCP's operational capacity to continue providing critical functions may also create a risk for financial stability.

Guideline 7 on the determination with respect to other requirements for continuing authorisation – a determination under Article 22(3)(a) of CCPRRR

Guideline 7

In determining if an infringement, or likely infringement, would justify the withdrawal of the authorisation of a CCP pursuant to Article 20 of EMIR the relevant authorities should consider the likelihood of the CCP to remain a going concern post application of the recovery tools, and assess whether the CCP could meet the requirements for continuing authorisation post-recovery as well as whether the CCP's reliability and capacity to provide clearing services has been severely impeded.

The relevant authorities should base their assessment on objective elements, including amongst others:

- a) Whether the CCP has the ability to continue providing clearing services in a manner which does not pose significant risk to the financial system, including an assessment of concentration due to the composition of clearing participants;
- b) Whether the CCP has the ability to undertake changes, wholly or in part, to ensure the CCP is no longer breaching the requirement that led to the infringement or avoiding a likely infringement from materialising, such as significant inadequacies in the CCP's risk management framework or rulebook, that led to the implementation of the recovery plan;
- c) Whether the material deficiencies in the internal controls and other key areas of the governance arrangements would negatively affect the ability of the CCP to operate in a compliant, transparent and effective manner.

This assessment on whether the CCP still fulfils requirements for continuing authorisation should be done in conjunction with the forward-looking elements related to financial resources, liquidity arrangements and operational capacity.

With regard to Guideline 7(a), the significant concentration of a CCP's clearing participants due to the composition of clearing members and clients, and such a concentration can for instance be measured by the number of clearing members or client clearing accounts, the levels of clearing members' exposures, initial margin or default fund contributions.

With regard to Guideline 7(b), the significant inadequacies in the CCP's risk management framework and/or rulebook may refer to the CCP's margins, stress-testing, collateral, default management and/or business continuity policies and procedures.

With regard to Guideline 7(c), such deficiencies in the internal controls and other key areas of the governance arrangements of the CCP may be evidenced by:

- a) fraud such as material misstatements in the financial statements by the staff and/or management of the CCP;
- b) disregard of the staff and/or management in relation to business activities and/or risk management framework of the CCP, including the failure to report and act on material weaknesses, deficiencies or issues;
- c) major reputational depreciation resulting from the non-compliance with 'fit and proper' criteria of individuals with key functions in the CCP; and
- d) major reputational depreciation arising from a lack of transparency in the conduct of business and operations or incomplete/inaccurate disclosure of information.

Guideline 8 Information provided by the competent authority

In accordance with Article 22(2) of CCPRRR "for the purposes of point (a)(ii) of paragraph 1, the competent authority shall provide the resolution authority on its own initiative and without delay with any information that may give an indication that the CCP is failing or likely to fail. The competent authority shall also provide the resolution authority upon request with any other information needed in order to perform its assessment.

In order to allow the resolution authorities to determine whether a CCP is failing or likely to fail, the competent authorities should provide all the necessary information to the resolution authorities. In this respect, Guideline 8 clarifies the type of information to be provided by the competent authority to the resolution authority.

Guideline 8

For the purpose of determining whether the CCP is failing or likely to fail, the competent authority should provide the resolution authority with the outcomes of the review and evaluation performed pursuant to Article 21 of EMIR.

In particular, the competent authority should notify the resolution authority and provide it with the following information in respect to the specific CCP:

- a) a summary of the outcomes of the review and evaluation performed pursuant to Article 21 of EMIR;
- b) the complete set of indicators used in the regular review and evaluation of key indicators of the CCP;
- c) all details on the applied supervisory measures and early intervention measures (according to Article 18(1) of CCPRRR), as well as a description of the CCP's compliance with them; and
- d) details on the recovery options applied by the CCP, where relevant.

In addition, upon identifying the presence of the objective elements listed in Guidelines 3 to 7 of these Guidelines, for the purpose of determining whether the CCP is failing or likely to fail, the resolution authority may request the competent authority to explain whether and how these circumstances have been reflected in the review and evaluation of the CCP.

Guideline 9 Information provided by the resolution authority

Guideline 9 clarifies the type of information to be provided to the competent authorities by the resolution authorities in order to ensure timely determination whether a CCP is failing or likely to fail.

Guideline 9

The resolution authority should, in writing, provide the competent authority with its findings and reasoning upon the identification of any of the objective elements listed in Guidelines 3 to 7 of these Guidelines.