



European Securities and
Markets Authority

Consultation Paper

**Draft RTS specifying the conditions for recompense (Article 20(2) of
CCPRRR)**



Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

- 1) respond to the question stated;
- 2) indicate the specific question to which the comment relates;
- 3) contain a clear rationale; and
- 4) describe any alternatives ESMA should consider.

ESMA will consider all comments received by 20 September 2021.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading '[Data protection](#)'.

Who should read this paper?

All interested stakeholders are invited to respond to this consultation paper. In particular, responses are sought from central counterparties (CCPs) and their clearing members.

Table of Contents

1	Executive Summary	5
2	Legislative references, abbreviations and definitions	6
3	Background	7
4	Scope of the mandate	8
5	Conditions for the recompense	9
5.1	Requirements for recompense	9
5.1.1	Non-default event	9
5.1.2	Non-contractually committed losses stemming from VMGH measures	9
5.1.3	Allowing the CCP to avoid resolution	10
5.2	Order in which the recompense must be paid	10
5.3	Maximum number of years and maximum share of the CCP's profits	12
6	Annexes	16
6.1	Annex I - Legislative mandate to develop technical standards	16
6.2	Annex II - Cost-benefit analysis	17
6.3	Annex III - Summary of questions	25
6.4	Annex VI - draft technical standards specifying the conditions for the recompense under Article 20(1)	26

1 Executive Summary

Reasons for publication

Article 20(1) of Regulation (EU) 2021/23 ('RRR') introduces a recompense mechanism, where a CCP in recovery caused by a non-default event has applied the arrangements and measures to reduce the value of any gains payable to non-defaulting clearing members set out in the recovery plan, and as a result has not entered into resolution. In that case, the CCP's competent authority may require the CCP to compensate the clearing members for their losses or require the CCP to issue instruments recognising a claim on its future profits. This recompense mechanism only applies to losses not contractually committed in the default management or recovery phases.

Article 20(2) of the RRR mandates ESMA to develop draft regulatory technical standards to specify the conditions of this recompense mechanism. The RTS shall specify the order in which the recompense must be paid, the maximum number of years during which instruments recognising a claim on future profits of the CCP shall entitle the possessor to receive payments, and the maximum share of a CCP's annual profit that shall be used towards payments relating to these instruments.

ESMA shall submit those draft regulatory technical standards to the Commission 12 months after the RRR entered into force.

Contents

This consultation paper presents the draft regulatory technical standard providing for the conditions of the recompense under Article 20(1) of RRR.

In particular, Section 5.2 further describes the order of recompense set out in the draft RTS, and Section 5.3 further specifies and provides the rationale for choosing the appropriate maximum number of years and maximum share of profits.

Annex VI contains the full text of the draft RTS.

Next Steps

The consultation will be open until 20 September 2021. ESMA will consider the feedback received to this consultation in Q3 2021 and expects to publish a final report and submission of the draft technical standards to the European Commission for endorsement in Q1 2022.

2 Legislative references, abbreviations and definitions

Legislative references

RRR 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 (OJ L 22, 22.1.2021, p. 1)

EMIR European Market Infrastructures Regulation – Regulation (EU) No 648/2012 of the European Parliament and Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.7.2012, p. 1)

Abbreviations

CCP	Central Counterparty
CPMI	Committee on Payments and Market Infrastructures
EC	European Commission
ESMA	European Securities and Markets Authority
FSB	Financial Stability Board
IOSCO	International Organisation of Securities Commissions
OJ	The Official Journal of the European Union
RTS	Regulatory Technical Standards

3 Background

1. The objective of a credible recovery and resolution framework is to ensure, to the greatest extent possible, that EU CCPs set out measures to recover from financial distress, to maintain the critical functions of a CCP which is failing or likely to fail while winding up the remaining activities through normal insolvency proceedings, to preserve financial stability and to avoid a significant adverse effect on the financial system and its ability to serve the real economy while minimising the cost of a CCP failure to taxpayers.
2. The recovery and resolution framework bolsters the preparedness of CCPs and authorities and provides authorities with powers to prepare for the potential resolution of a CCP and deal with the declining health of a CCP in a coordinated manner, thus contributing to the smooth functioning of financial markets.
3. The EC adopted the regulation on the recovery and resolution of CCPs (RRR)¹ on 16 December 2020 and it entered into force on 12 February 2021.
4. Article 20(1) of the RRR introduces a recompense mechanism, where a CCP in recovery caused by a non-default event has applied the arrangements and measures to reduce the value of any gains (i.e. variation margin gains haircutting (VMGH)) payable to non-defaulting clearing members and as a result has not entered into resolution. In that case, the CCP's competent authority may require the CCP to compensate the relevant clearing members for their losses or require the CCP to issue instruments recognising a claim on its future profits. This recompense mechanism only applies to losses not contractually committed in the default management or recovery phases.
5. Article 20(2) of the RRR mandates ESMA to develop draft regulatory technical standards to specify the conditions of this recompense mechanism.
6. In preparing this consultation paper, ESMA has taken into account, as much as possible, the CPMI-IOSCO guidance on recovery of FMIs and the FSB guidance on the resolution of CCPs.

¹ 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
https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_.2021.022.01.0001.01.ENG&toc=OJ%3AL%3A2021%3A022%3ATOC

4 Scope of the mandate

7. Under Article 20(1) of the RRR, EU CCPs may be required to compensate their clearing members for their losses, where they have applied VMGH measures in recovery following a non-default event, and as a result has not entered resolution.

Recital 27

In the exceptional cases of variation margin gains haircutting following a non-default event and if recovery is successful, the competent authority should be able to require the CCP to recompense its clearing members proportionate to their loss in excess of their contractual commitments, through cash payments or, where appropriate, to require the CCP to issue instruments recognizing a claim on the future profits of the CCP.

Article 20(1)

Without prejudice to the responsibility of clearing members to take losses which go beyond the default waterfall, where a CCP in recovery caused by a non-default event has applied the arrangements and measures to reduce the value of any gains payable by the CCP to non-defaulting clearing members set out in its recovery plan, and as a result has not entered resolution, the competent authority of the CCP may require the CCP to recompense the clearing members for their loss through cash payments or, where appropriate, may require the CCP to issue instruments recognising a claim on the future profits of the CCP. The possibility to provide recompense to non-defaulting clearing members shall not apply to their contractually committed losses in the default management or recovery phases.

The cash payments or the value of instruments recognising a claim on future profits of the CCP issued to each affected non-defaulting clearing member shall be proportionate to its loss in excess of its contractual commitments. The instruments recognising a claim on future profits of the CCP shall entitle the possessor to receive payments from the CCP on an annual basis until the loss has been recouped, if possible in full, subject to an appropriate maximum number of years from the date of issuance. If the non-defaulting clearing members have passed on the excess losses to their clients, the non-defaulting clearing members shall be obligated to pass the payments received by the CCP on to their clients, to the extent that the losses being recompensed refer to arise from client positions. An appropriate maximum share of the CCP's annual profits shall be used towards payments relating to those instruments.

8. As per Article 20(2) of the RRR, ESMA has a mandate to develop a draft RTS specifying the order in which such recompense must be paid, the appropriate maximum number of years and the appropriate maximum share of the CCP's annual profits that can be used in the context of this recompense scheme.

Article 20(2)

ESMA shall develop draft regulatory technical standards to specify the order in which recompense must be paid, the appropriate maximum number of years and the appropriate maximum share of the CCP's annual profits referred to in the second subparagraph of paragraph 1.

ESMA shall submit those draft regulatory technical standards to the Commission by 12 February 2022.

The Commission is empowered to supplement this Regulation by adopting the regulatory technical standards referred to in this paragraph in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010.

5 Conditions for the recompense

5.1 Requirements for recompense

9. Under Article 20(1) of the RRR a competent authority may require a CCP to compensate clearing members for their losses in a very specific scenario. The recompense may only be required by the competent authority (i) following a non-default event, (ii) where the CCP has applied measures to the value of gains payable to non-defaulting clearing members (i.e. the variation margin gains haircutting, also known as VMGH), which go beyond the contractually committed obligations, and (iii) that such measures have allowed the CCP to avoid being placed into resolution. ESMA's mandate under Article 20(2) of the RRR is to further specify the conditions of this compensation scheme.

5.1.1 Non-default event

10. In accordance with Article 2(9) of the RRR, a non-default event is a “scenario in which losses are incurred by a CCP for any reason other than a default event, including but not limited to, business, custody, investment, legal or operational failures or fraud, including failures resulting from cyber-attacks”. The draft RTS presented in this consultation paper only covers the situation where a CCP in recovery caused by a non-default event has applied the arrangements and measures to reduce the value of any gains (VMGH) payable by the CCP to non-defaulting clearing members set out in its recovery plan.

11. For the avoidance of doubt, a loss may occur from a non-default event at the same time as a default event but this would not affect the possibility of the competent authority of the CCP to require the CCP to recompense the relevant clearing members in relation to the relevant losses deriving from the application of VMGH measures following the non-default event.

5.1.2 Non-contractually committed losses stemming from VMGH measures

12. As specified under Article 20(1) of the RRR, the competent authority may require the CCP to recompense non-defaulting clearing members only where the CCP has applied VMGH measures, whilst contractually committed losses shall be excluded from the recompense.

13. It is therefore noted that VMGH makes it temporarily possible for CCPs to withhold variation margins that are calculated based on the exposure between the parties as calculated based on the CCP's margin/collateral framework/methodologies and that are due to be returned to the clearing member. Whilst the rulebook or the recovery plan of the CCP may very well regulate *how* VMGH measures are to be applied it is understood that for a VMGH measure to qualify for a possible recompense under Article 20(1) of the RRR it should have

been provided by the clearing member on a voluntary basis i.e. the clearing member should have consented to the application of VMGH measures at the time of their application. Any obligation on a clearing member to be applied VMGH measures would qualify as contractually committed or pre-agreed losses and would not qualify for possible recompense.

14. Hence, the competent authority may only require any potential recompense as referred to in Article 20(1) of the RRR and further specified in the draft RTS where the VMGH measures are not contractually pre-agreed between the CCP and the clearing member either in the CCP's internal rules or in a separate agreement with the CCP.

5.1.3 Allowing the CCP to avoid resolution

15. Under Article 20(1) of the RRR the recompense may only be required by the competent authority where the measures implemented by the CCP have made the recovery successful, i.e. where the CCP has not entered into resolution. In other words, should the CCP enter into resolution, even after having applied the VMGH measures referred to in Article 20(1) of the RRR, the competent authority may not require the CCP to compensate non-defaulting clearing members for their losses.
16. ESMA however notes that the criterion of not entering into a resolution is not further specified, hence there is no sequencing or time limitation to define that the CCP has avoided resolution. The timing of the contributions may though have an impact on if any recompense may be decided to be made to the relevant clearing members and the "order" of recompensate to ensure equal treatment if there are several non-default events.

5.2 Order in which the recompense must be paid

17. In accordance with Article 20(2) of the RRR, the draft RTS should first specify the order in which the recompense shall be paid.
18. In the context of the recompense under Article 20(1) of the RRR, it is understood that the "order of payment" refers to the order of priority between multiple non-defaulting clearing members which have been determined as eligible for compensation, i.e. that meet all the conditions under Article 20(1) of RRR (not being in default, having made a voluntary contribution, losses not contractually committed and the CCP having avoided resolution). The draft RTS should therefore specify the order in which different non-defaulting clearing members that are eligible for recompense (eligible claims) would be entitled to receive cash payments or receive and hold instruments recognising a claim on future profits in relation to the contribution made.
19. ESMA notes that the recompense of the eligible claims to non-defaulting clearing members shall be proportionate to their losses in excess of their contractual commitments. In order to ensure such proportionality, a first approach could therefore be not to specify any order between eligible claims, i.e. all non-defaulting clearing members would be treated equally.

20. However, this consultation paper considers another approach to reflect an order of payment. In order to incentivize clearing members to voluntarily contribute, i.e. by agreeing for the CCP to withhold variation margin payments due to the clearing member in order to help the CCP to avoid resolution, an order of priority could be established between all non-defaulting clearing members that contributed based on when they contributed. Under that “first-in / first-out” rule, the competent authority would require the CCP to recompense in priority clearing members for their contributions made on the first three working days following the request from the CCP (senior ranking claims) before any remaining clearing members contributing on the following days. In other words, late contributors would only be recompensed for example where all senior ranking CMs have been repaid in full.
21. Another aspect is where several non-default events occurs in sequence. ESMA has suggested to treat them as one non-default event as the CCP would not have been considered to have avoided resolution between the non-default events hence no separation between the non-default events is envisaged for the purpose of recompense. All contributors to the CCP would therefore be treated in accordance with the principles laid out below within such sequence of non-default events.
22. Under that approach of the order of payment, the RTS would therefore specify the following:
- The order of recompense among multiple non-defaulting clearing members entitled to recompense should depend on **when** such clearing member contributed i.e. where such contribution is made closer to the request of the CCP following a non-default event, (taking the date of the contribution as reference), such contribution would qualify as a senior ranking contribution and result *in a senior ranking claim*. Recompense shall be made in priority to such clearing members having made a senior ranking contribution and the senior ranking claim shall be recompensated in full before the remaining clearing members, that have voluntarily been subject to a VMGH measures, are subject to recompense;
 - The cash payments / distribution of instruments recognising a claim on future profits **shall be proportional** to the losses identified of each **equally ranked eligible claim** (i.e. senior ranking claims compared to other legitimate claims made by clearing members) by a non-defaulting clearing member; and
 - Where the compensation is provided both in cash and instruments recognising a claim on future profits, the split in allocating the different instruments of recompense against eligible claims among non-defaulting clearing members, should be identical.
23. In addition, ESMA notes that under Article 20(1) of the RRR the recompense payments to the holders of instruments recognising a claim on future profits shall be taken from the CCPs’ future annual profits². In order to ensure consistency in the application of the

² Within the limits in terms of number of years and share set out in this draft RTS.

recompense payments, when defining the order of the recompense payments the draft RTS shall also consider how to define the profits in this context.

24. For consistency, it is suggested that the profits shall have the same meaning as defined in the applicable accounting framework in the CCP's jurisdiction. However, it shall specify that any amount distributed under a profit-sharing agreement shall be reintegrated in the CCP's profit calculation.

Question 1: Do you agree with the proposed order of payments for the recompense to non-defaulting clearing members, i.e. where a contribution made closer to the non-default event would qualify as a senior ranking contribution and result in a senior ranking claim?

Question 2: If you agree with establishing an order of senior payments for the recompense, please consider the following questions.

a) How long should the "senior period" run for, 1 day/1 week and should this period depend on if there is a sequence of non-default events? Should even more layers of priority be introduced?

b) Should senior ranking claims be recompensated in full before other qualifying claims are recompensated? If not, should any other balance between senior and other claims be introduced? If yes, how should it work and why would this be preferable to the proposed priority?

c) Do you agree that recompense shall be proportionate to the losses between equally ranking claims and that senior ranking claims shall have the same split between cash and instruments as other qualifying claims for recompense (i.e. not only cash to senior ranking claims and instruments of ownership to other qualifying claims)?

Question 3: If you do not agree with establishing an order of senior payments for the recompense as described in this paper, please explain why? How should a different order of recompense be structured? Should all qualifying recompense claims be treated *pari passu*?

Question 4: Do you agree with the proposed definition of profit for the purpose of the recompense scheme?

5.3 Maximum number of years and maximum share of the CCP's profits

25. In accordance with Article 20(2) of the RRR, the draft RTS shall specify the appropriate maximum number of years from the date of issuance of the instruments recognising a claim on future profits, during which the CCP will need to provide payments to its non-defaulting clearing members that are entitled to recompense.

26. Furthermore, the RTS shall also specify the appropriate maximum share of the CCP's annual profits that could be used for the recompense payments under the instruments providing a claim on the CCP's future profits.
27. ESMA notes that that the recital reflects that “the instruments recognising a claim on future profits of the CCP shall entitle the possessor to receive payments from the CCP on an annual basis until the loss has been recouped, *if possible in full*, subject to an appropriate maximum number of years from the date of issuance”. Based on this ESMA notes that a full recompense of non-defaulting clearing members is not assumed nor required under Article 20 of the RRR, but rather that a balance is envisaged to be sought between the different interests in the aftermath where such measures have been applied by a CCP.
28. Hence, when setting the two parameters, ESMA has considered the need to strike a balance between guaranteeing the interests of the possessors of the instruments of ownership (the non-defaulting clearing members entitled to recompense payments) and ensuring the CCP can maintain some level of capital reserves, e.g. to meet its investment needs.
29. On the one hand, ESMA notes that contributions through VMGH under Article 20(1) of the RRR are made voluntarily by non-defaulting clearing members, so that the CCP may avoid being placed into resolution. Where the competent authority decides to request compensation, the competent authority may want to grant a material share of the profits as recompense, to ensure that non-defaulting clearing members can recoup a substantial amount of their losses. ESMA therefore considered the need to not set too restrictive limits on the maximum share of profits and the maximum number of years where establishing the period over which recompense payments could be made.
30. On the other hand, ESMA notes that the full allocation of a CCP's profits to the recompense contributions, should it span over a large number of years, may jeopardize the viability of the CCP, e.g. by preventing it to make the necessary investments. Similarly, allowing such payments over a long period of time may diminish the attractiveness of the CCP for its shareholders or other investors.
31. ESMA notes the complexity of fully detailing prescriptive rules of recompense in the RTS as it would depend on the situation of the CCP at hand, i.e. what would be a suitable recompense period for the relevant CCP. It is for example difficult to envisage how profitable a CCP may be after such a voluntary contribution is made, hence it may be fair to assume that the CCP may be less profitable for some time after such a non-default event. It is equally difficult to envisage how the decisions of the CCP affecting its own profitability may be affected by the requirements for recompense, as a potential feedback effect of the recompense mechanism.

Setting the appropriate maximum share of profits

32. Considering the need to preserve the viability of the CCP while ensuring the non-defaulting clearing members receive recompense, the maximum share of profits set in the RTS

should allow CCPs to retain an appropriate share of profits for reinvestment purposes, as retained earnings or reserves.

33. ESMA carefully considered the wording under the RRR regulation and notes that to apply 100% as the maximum share of profit would probably not be in line with the Article 20 of RRR as it is envisaged that a full recompense may not be possible, hence recognising that a partial recompense seems to be envisaged in the regulation. ESMA also considered proportionality aspects to ensure the CCP is not unnecessarily restricted that could risk the CCP's future financial healthiness and attractiveness in the market.
34. In assessing the wording of the RRR ESMA also took note that a significant recompense seemed to be envisaged as Article 20(1) of RRR refers to "until the loss has been recouped, if possible in full". Hence the maximum share of the profit should not be placed too low as this could restrain the non-defaulting clearing members from being compensated where the CCP has financial resources and/or willingness to undertake such a recompense.
35. Based on this ESMA concluded that the suitable range would probably be between 60-80%. To follow up on this range ESMA carried out some further assessments to be in a position to suggest a maximum share of the profit.
36. Based on publicly available financial reporting data, ESMA notes that profits appropriation practices widely differ among EU CCPs. While some CCPs retained all their profits as retained earnings over the last three years, some other distributed as much as 90% of profits as dividends (see Table 1, based on available CCPs' data).

TABLE 1: RETAINED EARNINGS AS A SHARE OF THE CCP'S PROFITS

CCP	Retained earnings as a share of the CCP's profits		
	2019	2018	2017
BME Clear	10%	14%	10%
CC&G	38%	5%	5%
ECC*	0%	0%	0%
Eurex Clearing*	0%	0%	0%
EuroCCP	100%	100%	100%
LCH SA	36%	0%	8%
OMIClear	100%	100%	100%

*ECC and Eurex Clearing have both a full profit and loss transfer agreement with their parent company.

37. Considering the above, and the fact that the RTS only sets a maximum share of the CCP's annual profits and that ultimately the competent authority would be the one to set the final share of profits to be dedicated for recompense, ESMA concludes that setting the maximum share of profits at **70%** would be appropriate, as it would allow the competent authority sufficient flexibility to adapt the share of profits to the specific situation of the CCP whilst ensuring that the CCP have the possibility to manage part of its annual profits as it sees suitable.

Setting the appropriate maximum number of years

38. With regards to the maximum number of years and considering the likelihood of low profitability levels in the first years following a recovery, ESMA noted the importance not to redeem the ownership instruments too early, so that clearing members can recoup a fair amount of their losses.
39. In contrast, ESMA noted that it was important to set a hard limit on the number of years during which recompense payments could be made, in order to preserve the attractiveness of the CCP for external investors. ESMA indeed notes that a high level of indebtedness could diminish the attractiveness of the CCP as a company, and further reduce its ability to raise funds and ensure its viability following the recovery.
40. ESMA finally noted that the RTS would only set a maximum value for the number of years, but that the actual number of years of recompense would be left at the discretion of the competent authority. ESMA therefore concludes that the maximum could be set at **[10]** years, in order to leave sufficient flexibility to the competent authority.

Question 5: Do you agree with the proposed values for the maximum share of profits and maximum number of years for the recompense to be paid? If not, please explain why.

Question 6: If you prefer a different set of numbers for the maximum share of profits or maximum number of years, please explain why you prefer those levels.

6 Annexes

6.1 Annex I - Legislative mandate to develop technical standards

Article 20(2) of RRR states:

ESMA shall develop draft regulatory technical standards to specify the order in which recompense must be paid, the appropriate maximum number of years and the appropriate maximum share of the CCP's annual profits referred to in the second subparagraph of paragraph 1.

ESMA shall submit those draft regulatory technical standards to the Commission by 12 February 2022.

The Commission is empowered to supplement this Regulation by adopting the regulatory technical standards referred to in this paragraph in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010.

6.2 Annex II - Cost-benefit analysis

1. Introduction

Pursuant to the third subparagraph of the second paragraph of Article 20 of RRR the Commission is empowered to adopt a delegated act to supplement the RRR to specify the order in which recompense must be paid, the appropriate maximum number of years and the appropriate maximum share of the CCP's annual profit. ESMA shall develop draft regulatory standards to specify those aspects and ESMA shall submit those draft regulatory technical standards to the Commission by 12 February 2022.

In carrying out a cost benefit analysis on the draft regulatory technical standards it should be noted that:

- The main policy decisions have already been taken under the primary legislation (RRR) and the impact of such policy decisions have already been analysed to some extent by the Impact Assessment by the European Commission³;
- ESMA does not have the power to deviate from its specific mandate provided by the Commission.
- ESMA choices in implementing its mandate should be of a purely technical nature and not contain issues of a policy nature;
- In most circumstances ESMA's policy options are limited to the approach it takes on drafting the technical advice to the Commission in accordance with the mandate.

2. Background

Article 20(1) of RRR introduces a recompense mechanism, where a CCP in recovery caused by a non-default event has applied the arrangements and measures to reduce the value of any gains (i.e. variation margin gains haircutting (VMGH)) payable to non-defaulting clearing members and as a result has not entered into resolution. In that case, the CCP's competent authority may require the CCP to compensate the relevant clearing members for their losses in cash or require the CCP to issue instruments recognising a claim on its future profits. This recompense mechanism only applies to losses not contractually committed in the default management or recovery phases.

3. Options for the approach to be followed

Considering that ESMA's mandate is to develop draft regulatory technical standards to specify the order in which recompense must be paid, the appropriate maximum number of years and the appropriate maximum share of the CCP's annual profits, the only variable on which ESMA can apply and hence the actual option is to set a proportionate and transparent order of priority

³ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=SWD%3A2016%3A0368%3AFIN>

of recompense as between the non-defaulting clearing members and to specify the maximum number of years and maximum share of a CCP's profit and thereby providing the scope and setting the restrictions for when and how competent authorities may require a CCP to recompense the clearing members for their qualified losses.

4. Cost-benefit analysis

a) Order in which recompense must be paid

The below details the different corresponding options for the most suitable approach to be taken by the competent authorities on how to specify the order in which recompense must be paid. ESMA notes that the focus at this stage of the cost and benefit analysis is to establish if an order in the recompense creates the right incentive for clearing members to contribute voluntarily with VMGH, however ESMA would like to note that within the option chosen (except for Option 1) further finetuning has to be made in line with the questions asked in the consultation paper (see Questions 1-4).

Specific objective	Ensuring that where a competent authority decides to require a CCP to recompense the clearing members for their qualified losses this is done in a proportionate and fair manner, considering an order of recompense payments creating a suitable incentive to voluntarily contribute to the CCP.
Policy option 1	To not provide an order in which recompense must be paid.
How would this option achieve the objective?	This option would meet the mandate as the proposal would be to actually not propose an order in which recompense must be paid. It could meet the objective, if it is considered that any type of priority proposed may cause arbitrary and possibly contra-productive effects in the situation where a CCP would like to ensure that clearing members are interested to voluntarily agree to VMGH measures.
Policy option 2	To provide for a two layered order in which recompense must be paid.
How would this option achieve the objective?	This option would meet the mandate as it proposes a priority in which recompense must be paid. It would meet the objective if it is considered that to introduce a senior ranking priority based on when a clearing member decides to contribute is creating correct incentives in the situation where a CCP would like to ensure that clearing members are interested to voluntarily agree to VMGH measures and results in a fair distribution of recompense to clearing members with a legitimate claim.

Policy option 3	To provide for a multi-layered order in which recompense must be paid.
How would this option achieve the objective?	This option would meet the mandate as it proposes a priority in which recompense must be paid. It would meet the objective if it is considered that to introduce a multilateral sequencing in the ranking of priority of claims based on e.g. when a contribution is made and the size of the clearing members contribution would contribute to creating correct incentives in the situation where a CCP would like to ensure that clearing members are interested to voluntarily agree to VMGH measures and results in a fair distribution of recompense to clearing members with a legitimate claim.
Which policy option is the preferred one?	Option 2, given that Option 1 could be seen as too limited and Option 3 too complex. Option 2 would be the most appropriate and proportionate approach to specify the order in which recompense must be paid to ensure a clear incentive to contribute by clearing members and results in a fair distribution of recompense to clearing members with a legitimate claim.
Is the policy chosen within the sole responsibility of ESMA? If not, what other body is concerned / needs to be informed or consulted?	ESMA is only providing a technical advice to the Commission which has the delegated responsibility to define which option to choose pursuant to its Delegated Act.

Impacts of the proposed policies:	
Policy option 1	
Benefits	No order hence very simple but may not create an incentive as envisaged.
Regulator's costs	No costs are envisaged.
Compliance costs	For both CCPs and clearing members no compliance costs are envisaged.
Policy option 2	

Benefits	It will provide an incentive to contribute at an early inset of the CCP's decline or in a stressed financial situation without establishing a complex structure of different types of priority claims.
Regulator's costs	Very low
Compliance costs	For the CCP the compliance costs of this option may entail some costs for the CCP as whilst the rules should be applicable without discretion there would be some cost to establish control measures in form of procedures and reporting and IT tools to register contributions and corresponding claims and control measures in form of procedures and reporting. For the clearing members the compliance costs are very low as the applied priority should be clear.
Policy Option 3	
Benefits	It will provide an incentive to contribute at an early inset of the CCP's decline or in a stressed financial situation however, whilst it may create a well-considered structure based on fairness and incentive it may also raise issues as to proportionality and may be considered as too burdensome to implement bearing in mind the relatively limited scope of this applied order of priority.
Regulator's costs	Could be high in managing and monitoring depending on complexity.
Compliance costs	For the CCP the compliance costs of this option may entail some significant costs for the CCP as whilst the rules should be applicable without discretion there would be some cost to establish control measures in form of procedures and reporting and IT tools to register contributions and corresponding claims and control measures in form of procedures and reporting. For the clearing members fairly low as it is the CCPs' requirement to apply the order of payments.

Question 7: For the purpose of setting an order of payment, do you agree with the Option 2 of the cost-benefit analysis, if not please explain? Have you identified other benefits and costs not mentioned above associated to the proposed approach (Option 2)?

Question 8: If you advocated for a different approach, how would it impact the cost and benefit assessment? Please provide details.

b) Appropriate maximum number of years and share of the CCP’s annual profits

In accordance with Article 20(2) of RRR, the draft RTS shall specify the appropriate maximum number of years from the date of issuance of the instruments recognising a claim on future profits, during which the CCP will need to provide payments to its non-defaulting clearing members that are entitled to recompense. The RTS shall also specify the appropriate maximum share of the CCP’s annual profits that could be used for the recompense payments under the instruments providing a claim on the CCP’s future profits. ESMA has considered the need to strike a balance between guaranteeing the interests of the possessors of the instruments of ownership (the non-defaulting clearing members entitled to recompense payments) and ensuring the CCP can maintain some level of capital reserves, e.g. to meet its investment needs.

Below are detailed the different corresponding policy options on how to determine the appropriate maximum number of years and the appropriate maximum share of the CCP’s annual profit. ESMA notes that as it is the *maximum number of years* and *maximum share* of the CCP’s profit, hence it is for the competent authority to determine the actual number of years and actual share of profit for a certain event where it has been prescribed that the CCP shall recompensate eligible claims of qualifying clearing members. This affects the options set out below as ESMA has not covered options within a range, i.e. where the competent authority decides to apply a long period of time for recompense but with a low share of the CCP’s profit, as this decision would depend on the actual situation and the CCP at hand.

<p>Specific objective</p>	<p>Ensuring that where a competent authority decides to require a CCP to recompense the clearing members for their qualified losses this is done in a proportionate and fair manner, ensuring the obligation to recompensate such clearing members with eligible claims are balanced between the interest of clearing members to be compensated and the viability of the CCP as a competitive provider of clearing services.</p> <p>Hence, setting an appropriate limit on the maximum number of years and share of profits should ensure that the recompense payments do not jeopardize the viability of the CCP, nor diminish the attractiveness of the CCP for its shareholders and external investors over a long period.</p>
<p>Policy option 1</p>	<p>To set an unlimited maximum number of years and to set the maximum share of the CCP’s annual profits that could be used for the recompense payments to 100%.</p>

<p>How would this option achieve the objective?</p>	<p>This option would probably not meet the mandate as to systematically recompense the clearing members in full does not seem envisaged under the regulation, however any limitation is at the cost of the clearing members. This option may though be detrimental to the viability of the CCP if maximum values are applied by the competent authority as it could diminish the attractiveness of the CCP for its shareholders and external investors over a long period.</p> <p>To ensure clearing members are incentivised to provide for voluntary support will in the end depend on the viability of the CCP, hence it may be fair to conclude that to balance the interest between clearing members and other stakeholders of the CCP, may be more efficient than ensuring clearing members are fully recompensated.</p>
<p>Policy option 2</p>	<p>To set the maximum number of years to a fairly high number of years, e.g. 10 years and to determine the maximum share of the CCP's annual profits that could be used for the recompense payments also fairly high, e.g. to 60-80%.</p>
<p>How would this option achieve the objective?</p>	<p>This option would meet the mandate and would achieve the objective of establishing a proportionate balance between clearing members and other stakeholders of the CCP.</p>
<p>Policy option 3</p>	<p>To set the maximum number of years to a very short period, e.g. 3 years and to determine the maximum share of the CCP's annual profits that could be used for the recompense payments also very low, e.g. 20-30%. leaving a fairly wide scope for distribution of profits.</p>
<p>How would this option achieve the objective?</p>	<p>This option may meet the mandate, but it may equally fall short of meeting the requirements that recompense "shall entitle the possessor to receive payments from the CCP on an annual basis until the loss has been recouped, if possible in full, subject to an appropriate maximum number of years from the date of issuance". It would likely be detrimental to the incentive for clearing members to contribute as those narrow ranges would most likely have a negative impact on the recompense level to clearing members.</p>
<p>Which policy option is the preferred one?</p>	<p>Option 2, given that Option 1 could be seen as tilting the balance too much in favour of clearing members and Option 3 could be seen as tilting the balance towards ownership interests and investors and may be challenged as not meeting the aim of the regulation. Option 2 would be the most appropriate and proportionate approach to ensure a clear incentive to contribute by</p>

	clearing members but to balance the interests of clearing members and other stakeholders of the CCP.
Is the policy chosen within the sole responsibility of ESMA? If not, what other body is concerned / needs to be informed or consulted?	ESMA is only providing a technical advice to the Commission which has the responsibility to define which option to choose pursuant to its Delegated Act.

Impacts of the proposed policies:	
Policy option 1	
Benefits	No limitations hence very simple but may create an unbalanced result and not in the best interest of the CCP, i.e. not meeting the objective of creating a viable CCP.
Regulator's costs	Normal costs, as it is envisaged under RRR that the competent authority will have to apply the ranges to the CCP and decide on the number of years and maximum share of profit.
Compliance costs	For both CCPs and clearing members no costs are envisaged to comply, but CCP may have high costs in attracting interest in ownership and investments due to the liability to clearing members until repaid. For the clearing members very low as the applied priority should be clear.
Policy option 2	
Benefits	It is a balanced approach between competing interests of the CCP, with the overall aim to ensure the CCP's viability.
Regulator's costs	Normal costs, as it is envisaged under RRR that the competent authority will have to apply the ranges to the CCP and decide on the number of years and maximum share of profit.
Compliance costs	For the CCP fairly low as the rules should be applicable without discretion. The CCP may however have somewhat higher costs in

	<p>attracting interest in ownership and investments due to the liability to clearing members until repaid.</p> <p>For the clearing members very low as the applied priority should be clear.</p>
Policy Option 3	
Benefits	This Option is beneficial to the CCP to the extent it may assist in ensuring ownership and investments are stable and viable, however, it will most likely result in a loss of incentives to voluntarily assist the CCP in financial difficulties.
Regulator's costs	Normal costs, as it is envisaged under RRR that the competent authority will have to apply the ranges to the CCP and decide on the number of years and maximum share of profit.
Compliance costs	<p>For the CCP fairly low as the rules should be applicable without discretion.</p> <p>For the clearing members very low as the applied priority should be clear.</p>

Question 9: For the purpose of setting the maximum number of years and maximum share of profits, do you agree with the Option 2 of the cost-benefit analysis, if not please explain? Have you identified other benefits and costs not mentioned above associated to the proposed approach (Option 2)?

Question 10: If you prefer a different approach, how would it impact this section on the cost and benefit assessment? Please provide details.

6.3 Annex III - Summary of questions

Question 1: *Do you agree with the proposed order of payments for the recompense to non-defaulting clearing members, i.e. where a contribution made closer to the non-default event would qualify as a senior ranking contribution and result in a senior ranking claim?*

Question 2: *If you agree with establishing an order of senior payments for the recompense, please consider the following questions.*

a) *How long should the “senior period” run for, 1 day/1 week and should this period depend on if there is a sequence of non-default events? Should even more layers of priority be introduced?*

b) *Should senior ranking claims be recompensated in full before other qualifying claims are recompensated? If not, should any other balance between senior and other claims be introduced? If yes, how should it work and why would this be preferable to the proposed priority?*

c) *Do you agree that recompense shall be proportionate to the losses between equally ranking claims and that senior ranking claims shall have the same split between cash and instruments as other qualifying claims for recompense (i.e. not only cash to senior ranking claims and instruments of ownership to other qualifying claims)?*

Question 3: *If you do not agree with establishing an order of senior payments for the recompense as described in this paper, please explain why? How should a different order of recompense be structured? Should all qualifying recompense claims be treated pari passu?*

Question 4: *Do you agree with the proposed definition of profit for the purpose of the recompense scheme?*

Question 5: *Do you agree with the proposed values for the maximum share of profits and maximum number of years for the recompense to be paid? If not, please explain why.*

Question 6: *If you prefer a different set of numbers for the maximum share of profits or maximum number of years, please explain why you prefer those levels.*

Question 7: *For the purpose of setting an order of payment, do you agree with the Option 2 of the cost-benefit analysis, do you agree with the Option 2 of the cost-benefit analysis, if not please explain? Have you identified other benefits and costs not mentioned above associated to the proposed approach (Option 2)?*

Question 8: *If you advocated for a different approach, how would it impact the cost and benefit assessment? Please provide details.*

Question 9: *For the purpose of setting the maximum number of years and maximum share of profits, 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)?*

Question 10: If you prefer a different approach, how would it impact this section on the cost and benefit assessment? Please provide details.

6.4 Annex VI - draft technical standards specifying the conditions for the recompense under Article 20(1)

COMMISSION DELEGATED REGULATION (EU) No .../..

supplementing Regulation (EU) No 2021/23 of the European Parliament and of the Council with regard to regulatory technical standards specifying the order in which recompense must be paid, the appropriate maximum number of years and the appropriate maximum share of the CCP's annual profits referred to in the second subparagraph of paragraph 1 of Article 20

of []

(text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 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 in particular Article 20(2) thereof,

Whereas:

- (1) The order in which recompense of non-defaulting clearing members pursuant to Article 20(1) of Regulation (EU) 2021/23 may be required by the CCP's competent authority should reflect a certain order of priority between the clearing members. In order to incentivize clearing members to voluntarily contribute to variation margin gains haircutting (VMGH) following a non-default event, an order of priority should be established between all non-defaulting clearing members that contributed based on the moment when they contributed.
- (2) In order to ensure a fair and proportional treatment among non-defaulting clearing members eligible for recompense, the recompense should be proportional to the losses identified of each equally ranked claim. Also, where there is a split between cash payments and instruments recognising a claim on future profits, the allocation

between the cash payments and those instruments should be identical for all recompensed non-defaulting clearing members.

- (3) The setting down of the maximum share of CCP profits from which the recompense is to be paid and the maximum number of years over which it is to be paid should allow the CCP's competent authority, where relevant, to require the CCP to grant a material share of the profits as recompense, to ensure that non-defaulting clearing members can recoup a substantial amount of their losses. At the same time, setting an appropriate limit on the maximum number of years and share of profits should ensure that the recompense payments do not jeopardize the viability of the CCP, nor diminish the attractiveness of the CCP for its shareholders and external investors over a long period.
- (4) This Regulation is based on the draft regulatory technical standards submitted by the European Securities and Markets Authority (ESMA) to the Commission.
- (5) In accordance with Article 10 of Regulation (EU) 1095/2010 of the European Parliament and the Council of 24 November 2010, ESMA has conducted open public consultations on such draft regulatory technical standards, analysed the potential related costs and benefits and requested the advice of the Securities and Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010,

HAS ADOPTED THIS REGULATION:

Article 1

Order in which the recompense shall be paid

1. Where the competent authority of a CCP has required the CCP to recompense clearing members in accordance with Article 20(1) of Regulation (EU) No 2021/23 through cash payments or where it has required the CCP to issue instruments recognising a claim on the future profits of the CCP, and where several non-defaulting clearing members are eligible for such recompense under the said Article 20(1), the recompense shall first be used to meet eligible senior ranking claims and only secondly the other eligible claims provided by non-defaulting clearing members.

For a claim to qualify as a senior ranking claim, a clearing member shall have contributed to the CCP in accordance with Article 20 of Regulation (EU) No 2021/23 within 3 working days following the request for contribution of the CCP.

2. All other contributions made by clearing members shall be considered as junior ranking claims and be subject to recompense after the senior ranking claims have been compensated in full.
3. Where the compensation referred to in paragraph 1 is done both in cash and through the distribution of instruments recognizing a claim on the CCP's of ownership in future profits,

the allocation or split between cash and non-cash recompense shall be identical among all eligible claims and the total recompense shall be proportional to the losses as identified of each equally ranked eligible claim of a non-defaulting clearing member.

4. Annual payments linked to instruments recognising a claim on the future profits of the CCP shall be taken from the CCP's profits, subject to the limits set in accordance with e Articles 2 and 3.
5. For the purposes of Article 20(1) of Regulation (EU) No 2021/23, the CCP's annual profit shall have the same meaning as under the applicable accounting framework for the CCP. Any profit-transfer agreement that may impair the profit level shall be reintegrated in the CCP's profit amount.

Article 2

Maximum share of the CCP's annual profits

Where a CCP is required to make annual recompense payments in accordance with Article 20(1) of Regulation (EU) No 2021/23, such annual recompense payments shall not exceed 70% of the CCP's annual profit for the year.

Article 3

Maximum number of years

Where a CCP is required to make annual recompense payments in accordance with Article 20(1) of Regulation (EU) No 2021/23, such annual recompense plan of payments shall not exceed 10 years.

Article 4

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President