Ladies and Gentlemen,

I am delighted to be in Frankfurt at this important conference and want to thank the Institute for Law and Finance for their kind invitation. This is a great opportunity to share with you some reflections on the important and complex topic of resolution. The timing of this discussion is especially relevant considering that the legislative process for the European framework for the resolution of CCPs is still ongoing.

We would all agree that European CCPs have become systemically important for the markets they clear and, through their interdependencies, for the European financial system as a whole - albeit some more than others. As for banks and insurance companies, a framework for the resolution of CCPs is needed in order to ensure the continuity of their critical services to preserve financial stability. Therefore, ESMA welcomes the Commission’s proposal for a European framework for the recovery and
resolution of CCPs\(^1\). As I have said before, CCPs without recovery and resolution plans are like vessels heading for the ocean, but without the lifeboats in place.

My first reflection is that the resolution framework for CCPs should not be considered in isolation, but in conjunction with the regulatory and supervisory framework applying to CCPs.

In the EU, the EMIR\(^2\) regulation introduced regulatory requirements aimed at ensuring the *Resilience* of CCPs under extreme but plausible market conditions. Accordingly, among other things, CCPs have to:

- maintain pre-funded resources to cover default losses under extreme but plausible market conditions, including at least the default of the two biggest clearing members;

- meet capital requirements to protect itself against the risks of non-default losses, like operational, legal and business risks; and

- apply concentration limits to contain investment and custody losses.

The forthcoming European regulation for the recovery and resolution of CCPs will introduce specific regulatory requirements for *Recovery* of CCPs, which under the current proposal would remain subject to the supervision of the relevant national competent authority and to the review of CCP Colleges. Currently, in compliance with the CPMI-IOSCO Principles for Financial Market Infrastructures, CCPs are developing


recovery plans to be able to address uncovered default losses beyond their pre-funded resources, as well as uncovered non-default losses.

Consequently, the Resolution of CCPs should focus on residual scenarios where a CCP is unable to implement its recovery plan or where the implementation of the recovery plan may negatively affect financial stability. A resolution plan should be designed around the specificities of a CCP’s business, its balance sheet structure, and take into account the scenarios that could lead to the resolution of the CCP. The ultimate objective of any intervention of a resolution authority in such scenarios should be to ensure the continuity of critical services to preserve financial stability.

*CCP Resilience, Recovery and Resolution are three essential “Rs” for CCPs, which are strictly interlinked*: on the one hand, strong resilience arrangements can reduce the likelihood of the need for recovery and resolution. While, on the other hand, recovery and resolution arrangements should maintain incentives to ensure resilience in the Business-As-Usual (BAU) situation. In my speech today, I would like to share my thoughts on:

i) how to strengthen CCP resilience through ongoing supervision; and

ii) how to ensure that recovery and resolution arrangements support strong CCP resilience.


**CCP Resilience and Supervision**

In the EU, the resilience of CCPs is a key objective of the regulatory and supervisory framework established under EMIR. The supervision of EU CCPs is assigned to the designated national competent authority of the Member State where a CCP is established, while CCP colleges have been established to enable cooperation among all relevant authorities in the EU with a legitimate interest in the ongoing resilience of that CCP.

Furthermore, EMIR tasked ESMA with a key role in promoting supervisory convergence through its participation in all CCP colleges, the conduct of peer reviews, and the adoption of other supervisory convergence tools, such as Q&As, Opinions and Guidelines. Moreover, in order to assess the resilience of CCPs, ESMA conducts an EU-wide stress test considering macro-economic stress scenarios developed together with the ESRB.

**EU-wide stress test**

I can proudly say that ESMA is among the pioneers in developing methodologies and building expertise in this new frontier of Supervisory Stress Tests for CCPs. ESMA conducted the first ever credit stress test of CCPs in 2016, which focused on counterparty credit risk and interdependencies across CCPs. More recently, ESMA completed a second stress test exercise applying both credit and liquidity stress tests, including an improved methodological framework for the stress test scenario definition and the result validation. We also published for the first time the individual results of the credit stress tests.
The results of this recent exercise\(^3\) confirmed that, overall, the system of EU CCPs is resilient to multiple clearing member defaults and extreme market shocks. However, for the credit tests the use of harmonised shocks permitted us to highlight differences in resilience between CCPs. This allowed us to identify minor failures of no systemic relevance for one CCP, and to highlight for another CCP a high sensitivity to marginal increases of the price shocks or the number of defaults, which may have systemic relevance. No systemic risk concerns were revealed by the liquidity stress tests.

ESMA’s EU-wide stress tests represent a complementary supervisory tool allowing the assessment of the resilience of CCPs from a macro-perspective. The primary tools ensuring resilience are the supervision of the efficiency and soundness of a CCP risk management framework and, in particular, its individual stress test framework. In that context, the EMIR supervisory framework has been a solid part of the EU post-crisis regulatory response. However, even good products can be improved and upgraded, especially when facing a changing environment. Therefore, let me reflect on the ongoing review of EMIR and, in particular, the proposal to strengthen the supervision of authorised EU-CCPs and recognised Third-Country CCPs (TC-CCPs), the so-called EMIR 2.2 proposal.\(^4\)

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CCP supervision under EMIR 2.2

Concerning TC-CCPs, ESMA welcomes the proposal to enhance the current recognition regime by introducing an enhanced regime for systemically important TC-CCPs, also referred to as Tier 2 CCPs.

The proposed new regime responds to the concerns raised by ESMA in 2014 in one of its reports on the EMIR review\(^5\), highlighting the limitations under the current recognition regime, whereby ESMA must fully rely on the supervision by the TC-CCP’s home jurisdiction authority. While obviously not foreseen in 2014, the limitations of this “full deference” model would especially materialise after Brexit.

The proposed new EMIR 2.2 regime entrusts ESMA with direct supervisory tasks over recognised Tier 2 CCPs, which are then subject to the requirements for CCPs under EMIR. The new regime also envisages the possibility to apply for “comparable compliance” in cases where the compliance with the regulatory requirements in the home jurisdiction would satisfy the requirements for CCPs under EMIR. This dual regime is in line with the model applied in other jurisdictions outside the EU and it would clearly better serve the post-Brexit landscape.

Regarding EU-CCPs, the Commission proposal retains the current decentralised supervision by the relevant NCAs, but enhances ESMA’s coordination role. For instance, it assigns ESMA the task to chair all CCP colleges and to provide its consent on specific supervisory decisions by a relevant National Competent Authority (NCA) on key CCP risk

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\(^5\) See EMIR Review Report no.4 of 13 August 2015 (ESMA/2015/1254).
requirements.

As you are all aware, I can say, with some understatement, that especially when compared with the proposed role regarding TC-CCPs, not all member states are enthusiastic about giving ESMA a more important role in the supervision of EU-CCPs. While understanding some of the concerns, it is important to have the right balance between EU-CCP supervision and TC-CCP supervision. Only in that way can we achieve the envisaged benefits in terms of scale and expertise, and this balance is also needed to ensure the credibility of EU supervision of TC-CPPs.

Let me take the opportunity to address one frequently heard argument against stronger EU CCP supervision, which is that as long as the resolution regime, which I will discuss later, will imply a fiscal impact on the member state where the CCP is located, the decision-making regarding CCPs should remain at national level.

However, I would like to note that the fiscal impact would never materialise if other recovery and resolution tools have effectively addressed any uncovered loss. Moreover, should the public financial support resolution tool be applied, this would cover only residual losses after other stakeholders, such as Clearing Members and CCP shareholders, beyond the national borders, had shared a substantial part of the initial losses. In this case, although the potential fiscal impact of a CCP resolution would remain in the Member State where the CCP is established, the economic impact of initial losses covered by prior recovery and resolution tools would have already affected other stakeholders across the EU.

Hence, considering the nature of CCPs, recovery and resolution inevitably
imply loss sharing across borders. Hence, limiting the losses of a CCP to the member state where the CCP is located is an illusion. Therefore, it is crucial to ensure that CCP supervision does not only respond to the national interests of where the CCP is located, but preserves the interests of all relevant stakeholders. The CCP colleges have helped to enrich the perspectives considered by the relevant NCAs in supervising CCPs. Still, the proposed amendments in EMIR 2.2 would better preserve the interests of all stakeholders involved.

Now, let me highlight one important aspect of the EMIR 2.2 proposal that, in my view, should be considered further and it relates to the governance of ESMA. The original proposal introduced a new, and separate, governance structure for the tasks assigned to ESMA on CCPs under EMIR 2.2. This would effectively create another ESMA independent of the existing ESMA structure, which would continue to be responsible for single rule book activities and some supervisory convergence activities regarding CCPs.

I am not supportive of this new governance arrangement, for two reasons. First, as both governance bodies would be involved in CCP matters, there would be the risk of uncoordinated decisions, strategies, and communication. Second, especially when taking into account the ESA review, it would make ESMA’s governance top-heavy and inefficient with a total of nine executives.

Noting that the current governance of ESMA is also under discussion in the ESA review, we need to ensure that the ultimate arrangements are efficient, that all ESMA decisions and activities regarding CCPs are well coordinated, and that ESMA has an integrated strategy and
communication. In that context, the proposal put forward to the Committee on Economic and Monetary Affairs of the European Parliament (ECON) by the Rapporteur of this dossier, MEP Danuta Huebner, is an important improvement.

I truly hope that EMIR 2.2 will progress on governance as it has done on improving the arrangements for the role of central banks. Considering the important links between CCPs, financial markets and monetary policy, it is imperative to ensure good cooperation between supervisors and central banks of issue. However, the original Commission proposals entailed the risk of deadlock as on a range of supervisory decisions the relevant national competent authority would have to seek the prior consent of both ESMA and the relevant central banks of issue.

Therefore, I very much welcome the recent amendment proposals being considered by the European Parliament, envisaging other cooperation arrangements, for instance, whereby ESMA would consult the relevant central banks of issue.

Finally, I would like to stress the importance of a timely adoption of EMIR 2.2. While the progress in the Brexit negotiations has resulted in an increased likelihood of a transitional regime, which is good news, it should not slow down the EMIR 2.2 legislative process. First, the transition regime is not yet certain, and there is still the risk that the UK-CCPs’ authorisations as EU-CCPs expire by the end of March 2019. Second, even when the transition regime ultimately comes into place, it will only delay the expiration date to the end of December 2020. By that time, the EU should have a functioning supervisory system for systematically important third-country CCPs, which is difficult to envisage if EMIR 2.2 is only agreed after
the next parliamentary elections.

**CCP Recovery and Resolution**

Turning to the core topic of today’s conference, I want to recall the main differences between recovery and resolution, which in my opinion should be reflected in the resolution framework for CCPs. A key difference between the two relates to the responsible actor. Whereas recovery is the responsibility of a CCP, resolution is under the responsibility of resolution authorities. However, there are further important differences.

*Different perspectives and objectives*

Recovery has a micro-perspective and the objective is to maintain the CCP’s viability as a going concern and to ensure the continuity of critical services. Recovery needs to address any uncovered loss, liquidity shortfall or capital inadequacy, arising from a participant default or other non-default causes, such as business, operational or other structural weaknesses.

On the other hand, the macro-perspective objective of resolution is to pursue financial stability, ensuring the continuity of critical services, either by restoring the ability of the CCP to perform those functions as a going concern or ensuring the performance of those functions by another entity or arrangement, coupled with the orderly wind-down of the CCP in resolution.
These different perspectives of recovery and resolution can result in a different classification of critical services and different strategies. Recovery should address all critical services essential to the viability of the CCP, while resolution should focus only on those critical services essential to preserve financial stability. This can lead to different strategies with respect to what services and business lines should be continued or wound-down.

Different scenarios

As I mentioned earlier, recovery should address scenarios where uncovered loss, liquidity shortfall or capital inadequacy, arise in unpredictable market circumstances beyond extreme, but plausible market conditions.

Resolution should then consider those most severe default and non-default scenarios where a CCP is not able to implement its recovery plan or where the implementation of the recovery plan may negatively affect financial stability. Resolution plans should be developed taking into account the constraints emerging under such scenarios.

Different tools

Resolution authorities should have the power to exercise all recovery tools envisaged in the CCP recovery plan, as reflected in the applicable CCP rules and other contractual arrangements. This is particularly relevant in those scenarios where the CCP is not able to implement its recovery plan.
Depending on the actual circumstances, the resolution authority should be enabled to implement the recovery plan, to the extent that this serves financial stability.

Moreover, resolution authorities should be empowered with additional resolution tools to address those scenarios where recovery tools are not sufficient to ensure the continuity of the CCP’s critical services for financial stability.

Against this background, I want to raise two “unresolved” questions on the resolution of CCPs and, without intending to pre-empt the discussion at the next Panel debate, I will provide my answers.

**When should a resolution authority intervene?**

The proposal for a European Regulation on CCP Recovery and Resolution envisages that a resolution authority should intervene when the following three cumulative conditions apply. First, the relevant competent authority or resolution authority, after consulting each other, shall determine that the CCP is “failing or likely to fail”; second, there is no reasonable prospect that alternative private sector measures or supervisory actions would prevent the failure of the CCP; and third, a resolution action is necessary in the public interest to preserve financial stability.

With respect to the first condition, the proposal for the Regulation envisages a mandate to ESMA to issue guidelines to determine the detailed circumstances under which a CCP shall be considered as failing or likely to fail. These guidelines would promote the convergence of
supervisory and resolution authorities’ determination of when the resolution of a CCP should be triggered.

Given the advancing legislative process, ESMA has initiated preparatory work for drafting these guidelines. We need to consider when a CCP shall be deemed to be failing or likely to fail. This would, for instance, include circumstances where the CCP infringes its authorisation requirements, becomes unable to provide a critical function or to pay its liabilities as they fall due, or to restore its viability through the implementation of its recovery measures. Please be assured that ESMA will seek the views of all relevant stakeholders through a public consultation in due course.

**Who should cover the losses in resolution?**

Understandably, this has always been a hotly debated issue. I believe that, as a general principle, the resolution authorities should seek to adhere to the CCP’s recovery plan to the largest possible extent in order not to alter the distribution of uncovered losses between its clearing members and shareholders, as contractually agreed.

However, in cases where the recovery tools would not serve the resolution objectives under the actual circumstances triggering the resolution of a CCP, the resolution authority should cautiously determine what alternative resolution tools to apply, in line with its resolution plan. In particular, the resolution authority should take into account the impact these tools would have on the stakeholders involved.

While fully recognising the need to introduce important safeguards, such
as the “no creditor worse off” principle, it is equally important that the resolution planning does not alter the incentives to the relevant stakeholders to contribute to an effective default management under, first, business-as-usual and, then, recovery.

Therefore, I welcome the resolution principles introduced in the proposal for Regulation on CCP Recovery and Resolution, and in particular the condition that any resolution tool based on public financial support to a CCP in resolution should be used as a last resort. Indeed, the proposal provides for a very rich set of resolution tools that should generally allow resolution authorities to handle both default and non-default scenarios without the need to rely on taxpayers’ money.

I would like to conclude my speech here and look forward to discussing further these and other “unresolved” questions with the other distinguished members on the next panel. I am confident that this debate provides a valuable contribution to the European co-legislators in identifying appropriate and balanced answers for the finalisation of the forthcoming European Regulation on CCP Recovery and Resolution.