

## Recovery and Resolution regime for CCPs

### Key principles

#### Note by the Post-trade Workstream of the IRSG

Central counterparties (CCPs) perform a specialist function in financial markets by assuming the counterparty credit risk between buyers and sellers in order to protect each of them from the default of another. Their role has been increased following the crisis as it is now the intention that a number of classes of OTC derivatives be subject to mandatory central clearing. CCPs employ sophisticated risk management processes to monitor their exposures and ensure that they hold financial resources that would be sufficient to prevent them failing, even in extreme circumstances. These have been further strengthened by EMIR. Nevertheless, it is important to prepare for the possibility, albeit remote, that these arrangements may prove insufficient and to put in place a regime to provide for the recovery of a CCP when its financial resources have been wiped out or, if recovery is impossible, for its orderly resolution. The design of this “Recovery and Resolution” regime for CCPs is currently being developed in the EU and this note proposes three principles to guide its design.

#### Principle 1: EU CCP recovery/resolution framework to be designed specifically for CCPs and not based on bank recovery/resolution

CCPs are specialist institutions and need a recovery and resolution regime designed specifically for CCPs and their specific business activities and risk profiles. Some CCPs are authorised as banks, either because there was no other authorisation available before EMIR or because this is necessary for access to central bank facilities. However, the activities that CCPs undertake are different from those of banks: for example, the objective of a CCP is counterparty risk mitigation whereas banks undertake risk-taking activities; CCPs rely on specific lines of defence, including the default waterfall, while banks only rely on capital. Given the specialist role of CCPs, it is not appropriate to take a banking recovery and resolution framework as the starting point for the CCP regime; this needs to be conceived from the outset as suitable for the particular requirements of CCPs. In particular the reaction of Clearing Members and their clients in advance of a failure should be carefully considered in the design of the recovery and resolution framework.

#### Principle 2: EU CCP recovery/resolution framework to be fully consistent with global CPMI-IOSCO and FSB standards

The risk management policies and resources of CCPs are designed to withstand “extreme but plausible” financial shocks and have proved effective in practice thus far. For example, the failure of Lehman Brothers in 2008 was absorbed by CCPs well within the pre-funded resources available. A shock that wiped out a CCP’s financial resources would be one that was outside anything experienced so far and would indicate widespread distress in the international financial system, for example, involving the simultaneous failure of several global banks. In these circumstances it would be important that the recovery and resolution regime applied to CCPs was robust and consistent internationally, as the failure would probably impact CCPs in several jurisdictions. International standards for recovery have been defined by CPMI-IOSCO<sup>1</sup> and for resolution by the FSB<sup>2</sup>. We encourage EU legislators to ensure that the EU regime adheres as closely as possible to these international standards.

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<sup>1</sup> <http://www.bis.org/cpmi/publ/d121.pdf>

<sup>2</sup> [http://www.financialstabilityboard.org/wp-content/uploads/r\\_141015.pdf](http://www.financialstabilityboard.org/wp-content/uploads/r_141015.pdf)

Principle 3: EU CCP recovery toolkits/resolution measures should only use participants' assets where such loss allocation provides the right incentives and is limited, quantifiable, proportionate and consistent

Much of the resources backing CCPs' loss absorption consists of the assets of participants. Any use of such assets to support the clearing services of a CCP should be done in a way that is proportionate, predictable and consistent. Creating a potentially open-ended or unpredictable liability for clearing members would put them in an impossible position. It would be perverse to ensure the survival of a CCP's services by causing the failure of its participants. It is likely that clearing members and their clients would respond to this risk by seeking to limit their exposure to the CCP, thus potentially limiting the resources actually available in a crisis and weakening financial stability overall.

We fully support the implementation of a recovery and resolution regime for CCPs in the EU, but for it to effectively achieve its objectives, we urge EU legislators to ensure that it follows the principles set out in this note.

*The International Regulatory Strategy Group (IRSG) is a practitioner-led body comprising leading UK-based representatives from the financial and professional services industry. It is an advisory body both to the City of London Corporation and to TheCityUK.*

*The Post Trade Workstream includes representatives from financial services firms, investors and financial market infrastructures, including exchanges, clearing houses and CSDs.*

*The objective of the Post Trade Workstream is to provide a cross-sectoral review of post-trade services. These comments reflect a consensus of views within the Workstream. The views of individual members may differ from the consensus in some areas.*

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