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# **EACH response to the ESMA consultation on Draft Guidelines on CCP recovery plan indicators (Article 9(5) CCPRRR)**

September 2021

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## Introduction

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The European Association of CCP Clearing Houses (EACH) represents the interests of Central Counterparties (CCPs) in Europe since 1992. CCPs are financial market infrastructures that significantly contribute to safer, more efficient and transparent global financial markets. EACH currently has 19 members from 15 different European countries. EACH is registered in the European Union Transparency Register with number 36897011311-96.

EACH appreciates the opportunity to provide feedback to the ESMA Consultation Paper “EACH response to ESMA consultation on Draft Guidelines on CCP recovery plan indicators (Article 9(12) CCPRRR)” (hereinafter called “The consultation”).

While we appreciate the objective to ensure an integrated framework for the recovery plan indicators, scenarios, and factors to be taken into account by the colleges when assessing recovery plans, we would generally caution against a too prescriptive approach on both the indicators and the scenarios. Below we describe our key considerations on this consultation:

### **1) Excessively prescriptive approach**

While Guidelines on the categories of indicators that should be included in the recovery plan could be helpful to improve consistency across the EU, we generally caution against including too detailed or specific indicators that have to be included in all recovery plans, irrespective of the particular risks faced by the CCP. Such requirements would be contrary to the principles set out the CCPRRR.

While ESMA’s mandate is to provide guidelines on the minimum list of indicators, Article 9(3) of CCPRRR explicitly states that the indicators should be identified by the CCP based on its risk profile. We therefore support the approach of a case-by-case analysis of indicators (qualitative or quantitative) in the recovery plan as Article 9 CCPRRR establishes. In this sense, it is important that each recovery plan includes a framework of indicators established by the CCP according to the relevant risks that it faces as the draft guidelines establish, identifying the points at which appropriate actions referred to in the plan may be taken, and such indicators shall be agreed by competent authorities when making the assessment of recovery plan.

### **2) Importance of proportionality and flexibility**

We kindly suggest that the requirement for a minimum list of indicators respects the principle of proportionality in terms of the size and complexity of the CCP. It is therefore important that the guidelines are structured with a view to promote the safety and soundness of markets and convergence of regulatory practice and not designed as burdensome and prescriptive requirements. Also, it is important to note that the thresholds for the recovery indicators should be considered as a reference, without assuming any automatic response in terms of recovery actions. Indicators just allow for assessing the underlying situation, and should not be seen as a trigger to take recovery actions but rather as the signal that an analysis should be done to determine what actions should be taken, if any. Moreover, due to the fact that several authorities will be involved, there is a risk that actions will be triggered too early.

### **3) Overall too complex**

In our view, the present tripartition proposed by ESMA and related number of minimum mandatory scenarios to be adopted by CCPs appears overly too complex to assure an effective recovery process. The number of indicators which would have to be adopted by a CCP under a baseline scenario (i.e. related to the number of minimum scenario proposed) seems not directly related to the risk profile of the CCP. In order to ensure consistency while at the same time guaranteeing proportionality to the system, the guidelines should only define a limited minimum set of indicators, leaving each CCP an appropriate degree of flexibility so as to identify, in accordance with relevant authorities, the most appropriate framework of indicators, depending on the risk peculiarities of the given CCP. We believe that the framework of indicators should be straightforward and the various indicators should always show a clear cut link with recovery phase. In designing a minimum framework, potential overlaps with BAU activities and situations should be avoided. Furthermore, the introduction of an excessively high number of indicators would add complexity to the system, making recovery less effective. Therefore, we kindly suggest ESMA to carefully consider the potential drawbacks of excessive complexity.

### **4) Adoption of category (a) indicators should be voluntary only**

We would suggest ESMA to reconsider the inclusion of early warning/category (a) indicators in the minimum list of indicators which shall be mandatorily adopted by CCPs. This would make the system more straightforward and proportionate and at the same time it would not prevent CCPs from adopting early warning indicators in the context of the CCP's governance arrangements, if deemed appropriate in light of the peculiar risk profile of the CCP and in accordance with competent authorities. Also, whereas the development by ESMA of a minimum list of category (b) and (c) indicators shows a clear link with the CCPRRR mandate envisaged in article 9 (4-5), the specification of a minimum list of early warning/category (a) indicators does not seem to be explicitly referenced in the context of the level 1 provisions.

Alternatively, we would respectfully suggest ESMA to complement the proposed categorisation by including, in respect to early warning indicators, additional flexibility for CCPs in defining the specific indicators pertaining to this category, as this would make the system more tailored on the specificities of CCPs.

### **5) Adoption of category (c) indicators should be optional or they should refer to types of recovery measures instead of specific ones**

Notwithstanding the above, in relation to category (c) indicators that signal the usage of specific recovery measures, EACH would also like to suggest that those indicators should either i) be made optional, i.e. to be used where a CCP considers such indicators appropriate in relation to the specific risks it faces and the recovery options available to it, or ii) should refer to *types* of recovery options for the CCP to assess and not trigger automatically *specific* measures. As rightly pointed out by ESMA, those indicators should entail some flexibility and not lead to the automatic display of a specific recovery measure, but rather identify the points at which appropriate actions referred to in the recovery plan should be evaluated and may be taken. *Types* of recovery options could for instance cover measures to restore the capital base,

measures to restore the liquidity position and measure to address operational deficiencies, plus others ESMA thinks might be relevant.

## Guideline 1: Objectives of the framework of CCP recovery plan indicators

### **Question 1: Do you agree with the overarching principle and objectives of the guidelines for the framework of CCP recovery plan indicators as set out in the proposed Guideline 1?**

As stated in Article 9 (3) CPRRR, recovery plan indicators should be identified by the CCP based on its peculiar risk profile and having regard to a principle of proportionality.

Indicators should, in the wider context of recovery, serve the specific purpose of identifying the points at which appropriate actions referred to in the recovery plan may be taken. The adoption of a comprehensive framework of indicators is meant to streamline and assure the timely implementation of predetermined recovery procedures, by identifying ex ante clear qualitative or quantitative risk-based markers. It is however important to note that the thresholds for the recovery indicators should be considered by CCPs solely as a reference, without assuming any automatic response in terms of recovery actions.

In this context, as referenced in Recital 19 of CCPRRR, a risk-based framework of recovery plan indicators should clearly be linked to situations encompassing either a significant deterioration in the CCP's financial situation or a risk of breach of its capital and prudential requirements, that if occurring would require the start of the appropriate recovery actions foreseen in the plan.

By specifying a minimum list of indicators, as per Article 9(5) of CCPRRR we kindly suggest ESMA to consider the potential drawbacks of an excessively prescriptive approach. In particular, to ensure consistency while at the same time guaranteeing proportionality to the system, the guidelines should only define a minimum set of indicators, leaving each CCP an appropriate degree of flexibility to identify, in accordance with relevant authorities, the most appropriate framework of indicators, depending on the risk peculiarities of the given CCP. Furthermore, the introduction of an excessively high number of indicators would add complexity to the system, making recovery less effective.

Therefore, we strongly believe that indicators should always show a clear-cut link with recovery phase, and, in designing a minimum framework, potential overlaps with BAU activities and situations should be avoided.

## Guideline 2: Categories of CCP recovery plan indicators

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### **Question 2: Do you agree with the proposed Guideline 2 and the categorisation of CCP recovery plan indicators into the three categories? Would you propose a different categorisation?**

As stated above, we agree that indicators are intended to identify the points at which appropriate decision-making and actions referred to in the plan may be taken.

We are therefore in favour of indicators that signal the move from a BAU scenario to a recovery phase (referenced as category (b) indicators). On the other hand, we question the opportunity to introduce a further early warning category of indicators (referenced as category (a) indicators), which all CCPs would be mandated to include in their recovery plans.

The conditions which would be relevant for early warning indicators would complement the system by capturing circumstances where there would be a material probability of the need to adopt measures foreseen in the recovery plan. This perspective, which seems rather hypothetical, appears excessively formalistic, and adds unnecessary complexity to the system. Moreover, a clear connection with the start of the recovery phase or the adoption of recovery measures seems missing for this category of indicators, which seem to intend to anticipate effective recovery scenarios, thus confusing the lines between BAU arrangements and recovery arrangements. Furthermore, in certain instances there would also be overlaps with category (b) indicators, with the risk that recovery actions may be taken too late. In any case it would not be straightforward for CCPs to determine ex-ante the difference between a material and non-material probability.

Also, whereas the development by ESMA of a minimum list of categories (b) and (c) indicators shows a clear link with the CCPRRR mandate envisaged in Article 9 (4 and 5), the specification of a minimum list of early warning/category (a) indicators does not seem to be explicitly referenced in the context of the level 1 provisions.

In light of the above listed considerations, we would suggest ESMA to reconsider the inclusion of early warning category (a) indicators in the minimum list of indicators which shall be mandatory adopted by CCPs. This would make the system more straightforward and proportionate and at the same time it would not prevent CCPs to adopt early warning indicators in the context of the CCP's governance arrangements, if deemed appropriate in light of the peculiar risk profile of the CCP and in accordance with competent authorities.

Alternatively, we would respectfully suggest nonetheless ESMA to complement the proposed categorisation by including, in respect to early warning indicators, additional flexibility for CCPs in defining the specific indicators pertaining to this category, as this would make the system more tailored on the specificities of CCPs.

Notwithstanding the above, in relation to category (c) indicators that signal the usage of specific recovery measures EACH would also like to highlight that those indicators should either not be mandatory or, referring to ESMA's caveat in the consultation paper, they should entail some flexibility and not lead to the automatic display of a *specific* recovery measure, but rather identify the points at which appropriate actions referred to in the recovery plan should be evaluated and may be taken. We would therefore encourage a clarification that category (c) indicators refer to *types* of recovery options and not to *specific* measures.

### Guideline 3: Creating CCP recovery plan indicators

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**Question 3: Do you agree with the proposal to link each recovery plan scenario of a CCP with at least one 'indicator that provides early warning for recovery actions' and one 'indicator that signals the move from Business as Usual risk management to the recovery phase'? Would you propose a higher number of indicators for each scenario?**

As mentioned above, we agree that indicators should serve the purpose of identifying the points at which appropriate decision-making and actions referred to in the plan may be taken. However, we would not agree with linking each recovery plan scenario with any specific indicator. While the scenarios are hypothetical in nature for providing a realistic and detailed picture of the risk facing a CCP, the indicators should be established on the basis of quantitative metrics in relation to the CCP's financial and operational position linked to the activation of the recovery plan. Therefore, the indicators could rather be used to assess various risk scenarios to determine which risks likely trigger a possible scenario.

Further, as mentioned above, we would encourage ESMA to consider not including early warning category of indicators in the list of minimum indicators that would need to be adopted by the CCP (which would not be precluded to adopt if deemed appropriate) and to explicitly clarify that category (c) indicators would not trigger *specific* recovery measures but rather refer to *types* of recovery measures for the CCP to assess. We do not suggest a higher number of indicators for each scenario, as the most appropriate number of indicators should be assessed on a case-by-case basis by the CCP, depending on its risk profile and in accordance with authorities.

**Question 4: Do you agree with the list of proposed indicators for each scenario as set out in Table 1? Would you add/delete any?**

Overall, as stated in our answer to question 3, we are of the opinion that the inclusion of mandatory early warning category (a) indicators in the minimum list of indicators adopted by CCPs should be reconsidered, as we suggest that CCPs should retain the freedom to decide if the inclusion of early warning indicators would be appropriate in light of the peculiar risk profile of the CCP and in accordance with competent authorities. Alternatively, we would kindly suggest nonetheless ESMA to complement the proposed categorisation by including in respect to early warning indicators additional flexibility for CCPs in defining the specific

indicators pertaining to this category, as this would make the system more tailored on the specificities of CCPs.

Having said that, we would like to signal the following observations related to the list of indicators envisaged in the draft proposal. As general remarks, we would like to stress that some of the proposed category (a) indicators overlap with category (b) indicators, thus creating inconsistencies in the system. Also, we would like to suggest that the various category (b) indicators referencing a realised or forecasted loss or shortfall, should only focus the concept of realised loss or shortfall in order to more precisely identify the start of the recovery phase (provided that in any case indicators should be considered by CCPs solely as a reference, without assuming any automatic response in terms of recovery actions).

Specifically, we would like to signal:

- Regarding scenario 1b, an interoperable CCP default under stress conditions and representing one of the largest exposures of the CCP represents one clear signal to move from Business-as-Usual risk management scenario to the recovery phase, rather than an early warning indicator. The early warning indicator overlaps with category (b) indicator and it should be deleted. For similar reasons we propose also to delete the third early warning indicator on combined default of a member and an interoperable CCP.
- Regarding scenario 3, the early warning indicator referencing a likely change in the legal frameworks seems too vague and difficult to implement.

**Question 5: Do you agree with the degree of granularity of the proposed indicators (as set out in Table 1) or should these be more prescriptive? Example: to assess the reduced liquidity of a market and the increased likelihood of being unable to reach a balanced book, the indicators could be the withdrawal of one or several market participants, the trading volumes, and the typical transaction costs.**

We would refer to our suggested amendments proposed in our answer to question 4. We would in any case suggest considering that the level of granularity should be set in accordance with the principle of proportionality, leaving each CCP the possibility to undertake the actions deemed more appropriate on a case-by-case basis. In particular, too prescriptive indicators that may not properly fit all the circumstances should be avoided and we believe that the potential drawbacks of such an excessively prescriptive approach should be taken into account. As stated, to ensure consistency while at the same time guaranteeing proportionality to the system, the guidelines should only define a minimum set of indicators, leaving each CCP an appropriate degree of flexibility to define, in accordance with relevant authorities, the most appropriate framework of indicators, depending on the risk peculiarities of the given CCP.

As indicated in our response to question 1 of the ESMA consultation on CCP Recovery Plan Scenarios, we propose, in line with ESMA's call for CCPs to design or build each scenario in a way that best fit their specific characteristics and level of complexity, not to require every CCP

to create at least one scenario for each of the seven types proposed by ESMA. Rather, we respectfully suggest allowing CCPs to use the scenario types in Table 1 to create the number of scenarios that are most meaningful to the CCP based on their risk profile and specificities, be this number smaller or larger than the seven proposed in the consultation paper.

**Question 6: Do you agree with the proposed approach for the ‘indicators that signal the usage of specific recovery measures’?**

Category (c) indicators should, in our opinion, provide some flexibility and not lead to the automatic display of a given recovery measure, but rather identify the points at which appropriate actions referred to in the recovery plan should be evaluated and may be taken. EACH would therefore also like to suggest that those indicators should either i) be made optional, i.e. to be used where a CCP considers such indicators appropriate in relation to the specific risks it faces and the recovery options available to it, or ii) referring to the above, that ESMA clarifies that category c) indicators refer to *types* of recovery options for the CCP to assess and not trigger automatically *specific* measures. Those types of recovery options could for instance cover measures to restore the capital base, measures to restore the liquidity provision and measures to address operational deficiencies, plus others that ESMA may consider relevant. As a point of reference, ESMA might want to look at already established recovery indicator frameworks, such as for example the broad categorization of recovery options established under the BRRD which could be adapted for CCPs.

#### **Guideline 4: Creating CCP recovery plan indicators**

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**Question 7: Do you agree with the proposed Guideline 4 on the integration of CCP recovery plan indicators with the CCP’s monitoring system, and with the list of risks, entities and issues that should be monitored?**

We agree that relevant indicators would need to be monitored on a regular basis. However, we would kindly question the proposal that CCPs should monitor a list of all relevant types and sources of risk proposed by ESMA. This does not adequately reflect a risk-based perspective, which should guide CCPs in the definition of the appropriate framework of recovery indicators and it lacks proportionality, so that it would be particularly burdensome for smaller CCPs. We encourage ESMA to consider adding flexibility to this guideline, including a reference to the need determine the list according to the CCP risk profile and the principle of proportionality.

According to CCPRRR Article 9(4), CCPs shall monitor on a regular basis the recovery plan indicators. The proposal of ESMA in paragraphs 39 and 40 is, in our opinion, beyond the scope of CCPRRR Article 9 (4 and 5). Well defined recovery plan indicators should already cover the relevant and material sources of risks. Regular monitoring (and reporting) of anything beyond the recovery plan indicators would not be proportional and outside the scope of the CCPRRR. The proposed additional monitoring requirements seems to be more fitting to BAU risk

management and are likely to be already monitored as part of that. We therefore kindly invite ESMA to reconsider the requirement proposed in this consultation to monitor anything beyond the recovery plan indicators themselves.

Furthermore, we would suggest ESMA to consider that, especially in terms of monitoring of the financial soundness and/or operational viability of third parties and interconnected FMIs, the state of information available to the CCP, is in many instances limited (e.g. CCPs do not have access to clearing members' recovery plans or to third party incident reports).

## Guideline 5: Maintenance of CCP Recovery Plan Indicators

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### **Question 8: Do you agree with the proposed Guideline 5?**

Overall, we agree that the review processes of the various elements of the recovery plan should be streamlined as much as possible, for the sake of effectiveness.

## Cost and benefit analysis

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### **Question 9: Do you agree with the Option 3, if not please explain? Have you identified other benefits and costs not mentioned above associated to the proposed approach (Option 3)?**

We concur that option 3 strikes the right balance between the need to foster supervisory convergence and the need to let CCPs tailor their framework of recovery indicators having regard to their specific risk profile. However, as stated above, we urge ESMA to consider the potential drawbacks of an excessively prescriptive approach. In particular, to ensure consistency while at the same time guaranteeing proportionality to the system, the guidelines should, in our opinion, only define a minimum set of indicators, leaving each CCP an appropriate degree of flexibility to identify, in accordance with relevant authorities, the most appropriate framework of indicators, depending on the risk peculiarities of the given CCP. Furthermore, the introduction of an excessively high number of mandatory indicators would add complexity to the system, making recovery less effective.

Therefore, while agreeing with option 3, we believe that excessively prescriptive minimum indicators would actually deliver added costs, while not benefitting the clarity and the overall simplicity of the system which should remained risk focused. The drawbacks, in terms of complexity, of an excessive number of indicators should also be taken into account.

### **Question 10: If you advocated for a different approach, how would it impact the cost and benefit assessment? Please provide details.**

We believe option 3 should be maintained although it should be refined in light of the suggestions proposed in this response. In particular, we believe that the framework should be less prescriptive, more proportionate and tailored on the precise risk profile of the given CCP. This would greatly benefit the effectiveness of the framework in the wider context of recovery planning.