

EU CCP Recovery and Resolution Regulation - Information for Clearing Clients for purposes of Article 9(23) and 87(7) of CCPR

The EU CCP Recovery and Resolution Regulation ("CCPR")¹ entered into force on 11 February 2021, however the provisions of CCPR to which this communication primarily relates come into force on 12 August 2022.

CCPR establishes a harmonised framework for the recovery and resolution of EU central counterparties ("CCPs"). CCPR is intended to ensure that both CCPs and their regulators will act decisively in a crisis scenario to keep CCPs providing their critical functions and to limit the impact on the financial system and on public funds.

Article 9 of CCPR requires CCPs to draw up and maintain a recovery plan providing for measures to be taken in the case of both default and non-default events, or combinations of both. The measures in the recovery plan are intended to restore the CCP to financial soundness without extraordinary public financial support, and allow the CCP to continue to provide critical functions following a significant deterioration of their financial situation or a risk of breaching their capital and prudential requirements under Regulation (EU) 648/2012 ("EMIR").

The purpose of this communication is (i) to provide information to clearing clients about how measures in a CCP's recovery plan might affect them (Article 9(23) CCPR), and (ii) provide information of the potential losses or other costs that clients may bear as a result of the application of default management procedures and loss and position allocation arrangements, under the CCP's operating rules, including the type of compensation they may receive, so that clients can understand the worst-case losses or other costs they could face should the CCP undertake recovery measures (Article 38(8) of EMIR, introduced by Article 87(7) CCPR).

For general information about how your positions may be impacted by the insolvency of a CCP, your attention is drawn to our Clearing Member Disclosure linked [here](#). This document also contains useful information about what happens if we are called into default by a CCP.

I. CCPR Resolution Tools

CCPR gives resolution authorities resolution tools to manage the failure of a CCP in an orderly way and to ensure that essential clearing functions and services are preserved.

Specifically, CCPR envisages the following resolution tools:

- (a) **the position and loss allocation tools**, including:
 - (i) **the tear-up tool**: This resolution tool allows the resolution authority to terminate specific clearing contracts to balance the books of the CCP. In practice, this tool would be used by a resolution authority if a clearing member defaults and its positions cannot be auctioned off. In these circumstances, the

¹ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R0023&from=EN>

resolution authority would terminate corresponding opposing positions to re-balance the CCP's books.

- (ii) **the variation margin gain haircut (VMGH) tool:** This resolution tool allows the resolution authority to reduce the amount the CCP owes a clearing member in respect of post-resolution variation margin gains due in accordance with the CCP's process for paying variation margin.

Both position and loss allocation tools may affect transactions we are clearing for ourselves as well as transactions we are clearing for you (or, where applicable, your clients).

- (b) **the write-down and conversion tool:** This resolution tool allows the resolution authority to write down or convert instruments of ownership, debt instruments or other unsecured liabilities of the CCP.
- (c) **the sale of business tool:** This resolution tool allows the resolution authority to sell all or part of the failing CCP to another entity.
- (d) **the bridge CCP tool:** This resolution tool allows the resolution authority to separate out essential functions of a CCP and transfer them to a new CCP (the bridge CCP), which is controlled by the resolution authority.

To apply the resolution tools, resolution authorities are given wide resolution powers, including the power to:

- (a) close out and terminate financial contracts;
- (b) reduce the amount of variation margin due to a clearing member;
- (c) cancel or modify the terms of a contract with the CCP;
- (d) suspend payment and delivery obligations;
- (e) restrict security interest enforcement; and
- (f) suspend termination rights.

The application of the resolution tools and powers under CCPR is subject to certain safeguards, such as the 'no creditor worse off' principle which seeks to ensure that creditors of the CCP should not incur losses greater than those which they would have incurred if the resolution authority had not taken resolution action in relation to the CCP and they had instead been subject to all applicable outstanding obligations pursuant to the CCP's default rules or other contractual arrangements in its operating rules, and the CCP had been wound up in normal insolvency proceedings.

II. CCP Recovery Plans and Default Management Procedures

Under Articles 40 to 50 of EMIR, CCPs are required to maintain a range of different types of financial resources that they can call upon to address credit and market risk. In particular, CCPs are required under EMIR to maintain pre-funded default funds to cover losses that exceed the losses covered by margin requirements, arising from the default of one or more clearing members. Every clearing member is required to contribute to the CCP default fund in cash or other CCP acceptable margin.

In certain circumstances, CCPs may call for further contributions (assessments) from their clearing members, however, EMIR requires that the contributions of the defaulting clearing member and the CCP's dedicated own resources are used before the CCP uses default fund contributions of other non-defaulting clearing members.

Under their default management procedures, CCPs may also impose additional obligations on clearing members, such as the participation in auctions of a defaulting clearing member's position. These measures are intended to enable the CCP to return to a matched book following termination of a defaulting clearing member.

The measures a CCP takes to restore a matched book are likely to differ depending on whether the products are exchange-traded derivatives (ETDs) or over-the-counter (OTC) cleared derivatives transactions.

The application of the measures in a CCP's recovery plan and any tools or powers exercised by resolution authorities may materially impact the value of transactions which the clearing member is clearing for its clients.

Tear Up Measures

The CCP's recovery plan may include tear-up measures similar to the resolution tear-up tool described above. If the CCP implements tear-up measures in respect of a transaction we are clearing for you, the CCP will terminate and cash settle the relevant transaction, perform a close-out calculation and pay any positive resulting sum to us. In this context, you may incur incidental costs in the process of the closing out of your transactions and you may incur additional costs if you decide to enter into a replacement transaction.

VMGH

If the CCP implements VMGH measures in respect of a transaction we are clearing for you, you may lose the entire variation margin gain since the last variation margin call.

Impact of measures in the CCP's recovery plan or resolution tools on clients' cleared positions

Under the client clearing agreement, your cleared transaction will terminate at the same time as the matching CCP transactions unless the relevant CCP rules provide otherwise. The termination of your transactions will result in a net sum owing between you and us in respect of the relevant CCP service. However, because of the limited recourse nature of client clearing arrangements, you will only receive amounts from us in relation to your cleared transactions if we receive equivalent amounts from the CCP in relation to the related CCP transactions. In a

worst case scenario, this means that you may not receive any amounts in respect of your cleared positions.

Examples of other actions which may impact client positions

CCPs have broad powers to take actions in the interests of financial stability, including by suspending or terminating a clearing member's access to clearing, or reducing limits. CCPs may also amend or increase the types of margin that they will accept or return to clearing members (as well as related haircuts).

As your clearing member, it may be necessary for us to take action to correspond with any such direction, action or event which a CCP takes in connection with its recovery plan or the direction of a resolution authority, as the case may be, or to mitigate any loss or other impact which results from such action or event, such as reducing clearing limits or closing out transactions or services which we offer. Our rights to take actions in that regard are set out in our agreement with you.

Where permitted under our clearing agreement with you, we may also pass costs or losses incurred in connection with the CCP's recovery plan or its resolution, however, we will only do so to the extent those losses or costs are attributable to your cleared positions.

III. Disclaimer

Recovery plans are not public and clearing members have to rely on voluntary disclosures by CCPs. Additionally, CCPs may take actions which are not reflected in the information they have provided. Therefore, there may be other ways in which a CCP's recovery plan may impact you which are not reflected in this communication.

The information in this communication is based on the general provisions of CCPR and EMIR. There has been only limited information made available by CCPs to us to date to meet the requirements of CCPR. In preparing this information, we have reviewed:

- Eurex client communication "Impact of Recovery and Resolution Tools on Clearing Members" dated July 2022²;
- EuroCCP website disclosure "Clearing Rules - consultation of rule book changes July 2022" dated 4 July 2022³;
- Nasdaq Clearing client communication "Notice Regarding Proposed Amendments to the Clearing Rules of Nasdaq Derivatives Markets" dated 2 August 2022⁴.

This communication may be updated from time to time as CCPs disclose information about their recovery plans or to reflect regulatory guidance.

Clients are therefore advised to consult the latest version of this communication, which will be available [here](#).

² Available from the CCP or by contacting your client service representative

³ https://www.euroccp.com/euroccp_resources/news_flashes/clearing-rules-consultation-of-rule-book-changes-july-2022

⁴ <https://www.nasdaq.com/solutions/rules-regulations-derivatives-rules>

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This communication does not constitute legal or any other form of advice and must not be relied on as such. This communication provides a high-level overview of a complex and new area of law, the effect of which will vary depending on the specific facts of any particular case. Clients are advised to consult the rulebook of the applicable CCP and any other resources made available by the CCP to understand how actions taken by the CCP may impact their cleared positions. You may wish to appoint independent professional advisors to advise you on this

If you have questions about the information in this communication, please contact your usual relationship manager.