

Response: ESMA Consultation Paper on draft Guidelines on the application of the circumstances under which a CCP is deemed to be failing or likely to fail

January 2022

Introduction

The World Federation of Exchanges (WFE) is the global trade association for regulated exchanges and clearing houses. We represent over 250 market-infrastructures, spread across the Asia-Pacific region (~37%), EMEA (~43%) and the Americas (~20%). with everything from local entities in emerging markets to groups based in major financial centres.

The WFE has previously sought to proactively contribute to the international debate on CCP risk management, recovery and resolution¹. In doing so, its members have contributed significantly to the strengthening of the system via the implementation of many post-crisis initiatives, including efforts to encourage central clearing of derivatives as per the G-20 direction.

We appreciate the opportunity to respond to the ESMA Consultation Paper relating to Draft Guidelines on the Application of the Circumstances under which a CCP is Deemed to be Failing or Likely to Fail. As detailed further below, while we agree with a number of the guidelines in principle, we believe that some of the proposed criteria to determine how and when resolution should be triggered are not entirely objective and do not fully take into account the costs and impact to the marketplace if a CCP is put in resolution prematurely.

In our view it is essential that CCP recovery is given every opportunity to succeed, as we believe resolution would likely have a significantly more negative impact on the overall market. We do not support resolution authorities seeking to interfere with – or override – the CCP's recovery process unless intervention is absolutely required to support financial or market stability.

The decision regarding when to invoke resolution should only be taken if it is clearly necessary to provide for continuity of clearing services and market stability.

We believe the interests of the financial system are best served by a regime that is designed primarily to avoid resolution and instead, incentivize market participants' active participation in the recovery process. In the extreme and remote scenario of a potential CCP resolution, the resolution authority should intervene after the exhaustion of the resources and tools defined for recovery in a CCP's rulebook and recovery plan. If a resolution authority were to intervene prior to this, the incentives market participants have to actively participate in the recovery process are undermined.

¹ - [WFE: CCP Risk Management Recovery and Resolution – Aligning CCP and Member Incentives – October 2015](#)
- [WFE: Response to CPMI-IOSCO Consultative Report Resilience and Recovery of CCPs – October 2016](#)
- [WFE: Response to FSB Discussion Note - Essential Aspects of CCP Resolution – October 2016](#)
- [WFE: The Interplay between Central Counterparty Recovery and Resolution: A Global Perspective – February 2017](#)
- [WFE: Response to FSB's Consultative Document on CCP Resolution & Resolution Planning – March 2017](#)
- [WFE: Response to FSB's Consultation Paper on Treatment of CCP Equity in Resolution – July 2020](#)

Response to questions:

Question 1: Do you agree with the proposed Guidelines 1 and 2, specifying the general considerations in determining if a CCP is failing or likely to fail? If not, please explain.

While we broadly agree with the proposed Guidelines, we note a significant difference between Guideline 1 and Guideline 2 in principle. Specifically, Guideline 1 refers to “available objective elements”, where the emphasis on objective measures is crucial. In order to be clear and predictable, the test must be based on hard evidence as to the CCP’s financial ability to continue to provide clearing services in a sound manner.

We also note that CCPs have tools and existing regulatory requirements to manage risks, including recovery plans. It is in our view essential, in the interests of avoiding premature intervention that would itself be damaging to financial stability, to ensure explicitly in the guidelines that all such tools and plans be fully respected and allowed to function, rather than cut short before they have had a chance to succeed. We also note that the authorities should take care to assess what private-sector alternatives are available, once it does become relevant to consider resolution.

For background, please feel free to refer to our letter² to Mr Klaus Löber, in his capacity as Chair of the ESMA CCP Supervisory Committee.

Question 2: Do you agree with the proposed Guideline 3, considering the availability and adequacy of the CCP’s recovery tools in determining if a CCP is failing or likely to fail? If not, please explain.

We agree with the proposed Guideline 3, with an important provision. As stated in our response to Question 1, it is essential not to ‘second-guess’ recovery plans, which exist for good reason and are performed to well established regulatory standards around the world. Interfering with these plans will, in our view, only add to financial instability, rather than reduce it.

Question 3: Do you agree with the proposed Guidelines 4 and 5, considering the financial resources of the CCP’s in determining if a CCP is failing or likely to fail? If not, please explain.

We agree with the draft Guidelines 4 and 5.

Question 4: Do you agree with the proposed Guideline 6, considering the operational capacity of the CCP in determining if a CCP is failing or likely to fail? If not, please explain.

We agree with the proposed Guideline 6 in principle. However, given the consequences of proceeding to an attempt at resolution, it is essential to minimise subjectivity in the extremely challenging circumstances of acting in a timely manner. For instance, it is not clear how one would determine instantaneously whether a CCP was unable to recover from a cyber-attack.

Similarly, the intention of market participants to alter their existing arrangements with CCPs are notoriously performative, and to a large extent dependent on the attitude of the authorities and the marketplace overall towards any institution (CCP or otherwise) that may be in difficulty at a given point in time. Moreover, those intentions may well reflect expectations as to the performance of other market participants, rather than the CCP per se.

Furthermore, a reduction in the number of contracts or transactions submitted for clearing may reflect a reduction of positions and risk, rather than a judgement by market participants (which

²[WFE: Letter to Klaus Löber on CCP supervision](#)

could itself be overly conservative and not based on all applicable information) as to the CCP's viability. We note that there is no exact, quantifiable measure for loss of confidence.

Question 5: Do you agree with the proposed Guideline 7 specifying other requirements for continuing authorisation in determining if a CCP is failing or likely to fail? If not, please explain.

We agree with the proposed guideline.

Question 6: Do you agree with the proposed Guidelines 8 and 9 on information sharing? If not, please explain.

We generally agree, *provided* the information exchanged is based on objective criteria and, consistent with our comments on other questions in this consultation, does not consist of subjective judgements.

Question 7: Do you agree with the proposed Option 2? If not please explain. If yes, have you identified other benefits and costs not mentioned above associated [with] the proposed approach (Option 1)?

We agree with **Option 2** and welcome the fact that the 'failing-or-likely-to-fail' determination remains an expert judgement and is not automatically triggered by any of the objective elements alone (as outlined in paragraph 22 of the consultation paper).

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