



European Securities and
Markets Authority

Final Report

**Regulatory technical standards specifying the conditions for recompense
(Article 20(2) of CCPRRR)**

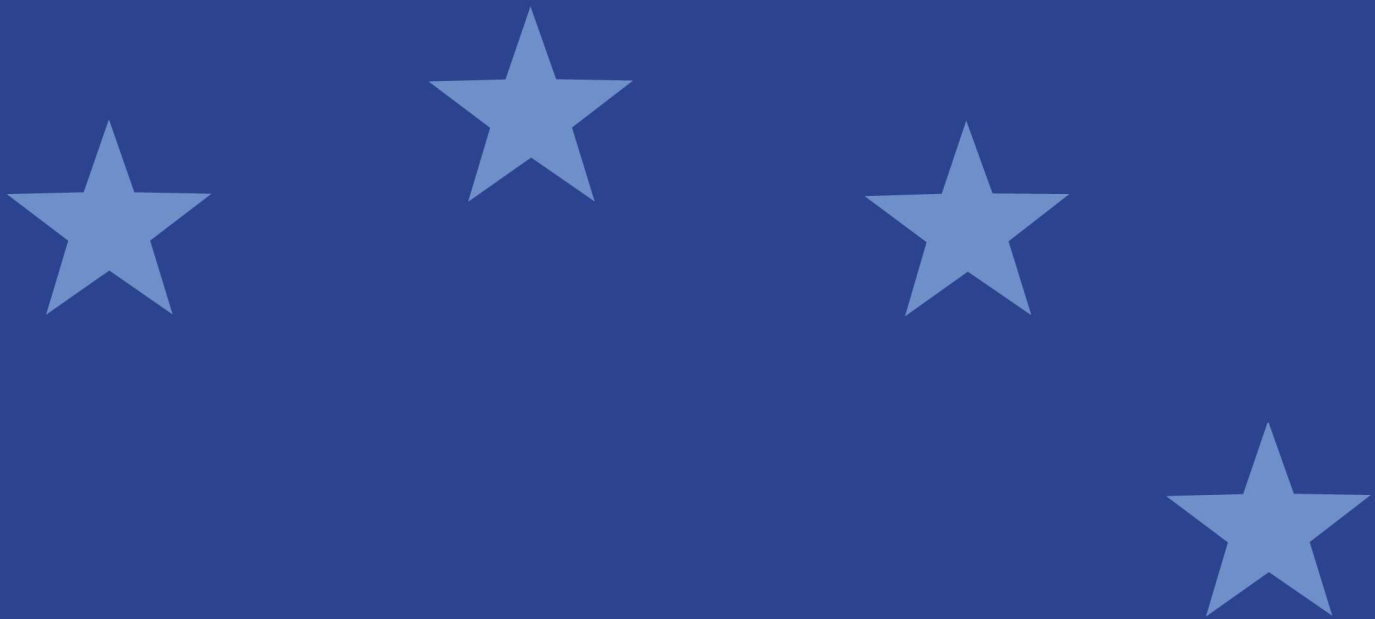


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1 Executive Summary

Reasons for publication

Article 20(1) of Regulation (EU) 2021/23 ('CCPRRR') introduces a recompense mechanism, where a CCP in recovery caused by a non-default event has applied the arrangements and measures to reduce the value of any gains payable to non-defaulting clearing members set out in the recovery plan, and as a result has not entered into resolution. In that case, the CCP's competent authority may require the CCP to compensate the clearing members for their losses or require the CCP to issue instruments recognising a claim on its future profits. This recompense mechanism only applies to losses not contractually committed in the default management or recovery phases.

Article 20(2) of CCPRRR mandates ESMA to develop draft regulatory technical standards (RTS) to specify the conditions of this recompense mechanism. The RTS shall specify the order in which the recompense must be paid, the maximum number of years during which instruments recognising a claim on future profits of the CCP shall entitle the possessor to receive payments, and the maximum share of a CCP's annual profit that shall be used towards payments relating to these instruments.

ESMA shall submit those draft regulatory technical standards to the Commission 12 months after the CCPRRR entered into force.

ESMA published a Consultation Paper with its draft regulatory technical standards under Article 20(1) of CCPRRR on 12 July 2021. The consultation ended on 20 September 2021. ESMA received 5 responses.

The Final Report takes into account the feedback provided by the respondents to the consultation, and noted the view of the Securities and Markets Stakeholder Group.

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The Final Report provides the draft regulatory standards specifying the order in which recompense must be paid, the appropriate maximum number of years and the appropriate maximum share of the CCP's annual profits referred to in the second subparagraph of paragraph 1 of Article 20 of CCPRRR.

Section 3 introduces the scope of the legal mandate and provides background on the circumstances under which a competent authority may require a CCP to recompense non-defaulting clearing members.

Sections 4 and 5 are then dedicated to the two elements that ESMA is mandated to specify in the draft RTS, i.e. the order of payment of the recompense (Section 4) and the maximum number of years and maximum share of the CCP's profits (Section 5). Each section provides background on the proposed approach, describes the feedback received from the public

consultation, and finally introduces the approach chosen by ESMA for the proposed draft RTS.

The Annexes contain the mandate for ESMA to develop these draft regulatory technical standards (Annex I), the cost-benefit analysis (Annex II), the advice of the SMSG (Annex III) and the draft regulatory technical standards (Annex IV).

Next Steps

ESMA is submitting the Final Report and draft regulatory technical standards to the European Commission. The Commission has three months to decide whether to adopt the regulatory technical standards (in the form of a Commission Delegated Regulation). Following the adoption by the Commission, the regulatory technical standards are then subject to non-objection by the European Parliament and the Council.

2 Legislative references, abbreviations and definitions

Legislative references

CCPRRR Regulation (EU) 2021/23 of the European Parliament and of the Council of 16 December 2020 on a framework for the recovery and resolution of central counterparties (OJ L 22, 22.1.2021, p. 1)

EMIR European Market Infrastructures Regulation – Regulation (EU) No 648/2012 of the European Parliament and Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.7.2012, p. 1)

Abbreviations

| | |
|--------------|--|
| <i>CCP</i> | Central Counterparty |
| <i>CM</i> | Clearing Member |
| <i>CPMI</i> | Committee on Payments and Market Infrastructures |
| <i>EC</i> | European Commission |
| <i>ESMA</i> | European Securities and Markets Authority |
| <i>FSB</i> | Financial Stability Board |
| <i>IOSCO</i> | International Organisation of Securities Commissions |
| <i>OJ</i> | The Official Journal of the European Union |
| <i>RTS</i> | Regulatory Technical Standards |

3 Background and scope of the mandate

3.1 Legal basis

1. Under Article 20(1) of CCPRRR, EU CCPs may be required to compensate their clearing members for their losses, where they have applied variation margin gains haircutting measures in recovery following a non-default event, and as a result has not entered resolution.

Recital 27

In the exceptional cases of variation margin gains haircutting following a non-default event and if recovery is successful, the competent authority should be able to require the CCP to recompense its clearing members proportionate to their loss in excess of their contractual commitments, through cash payments or, where appropriate, to require the CCP to issue instruments recognizing a claim on the future profits of the CCP.

Article 20(1)

Without prejudice to the responsibility of clearing members to take losses which go beyond the default waterfall, where a CCP in recovery caused by a non-default event has applied the arrangements and measures to reduce the value of any gains payable by the CCP to non-defaulting clearing members set out in its recovery plan, and as a result has not entered resolution, the competent authority of the CCP may require the CCP to recompense the clearing members for their loss through cash payments or, where appropriate, may require the CCP to issue instruments recognising a claim on the future profits of the CCP. The possibility to provide recompense to non-defaulting clearing members shall not apply to their contractually committed losses in the default management or recovery phases.

The cash payments or the value of instruments recognising a claim on future profits of the CCP issued to each affected non-defaulting clearing member shall be proportionate to its loss in excess of its contractual commitments. The instruments recognising a claim on future profits of the CCP shall entitle the possessor to receive payments from the CCP on an annual basis until the loss has been recouped, if possible in full, subject to an appropriate maximum number of years from the date of issuance. If the non-defaulting clearing members have passed on the excess losses to their clients, the non-defaulting clearing members shall be obligated to pass the payments received by the CCP on to their clients, to the extent that the losses being recompensed refer to arise from client positions. An appropriate maximum share of the CCP's annual profits shall be used towards payments relating to those instruments.

2. As per Article 20(2) of CCPRRR, ESMA has a mandate to develop a draft RTS specifying the order in which such recompense must be paid, the appropriate maximum number of years and the appropriate maximum share of the CCP's annual profits that can be used in the context of this recompense scheme.

Article 20(2)

ESMA shall develop draft regulatory technical standards to specify the order in which recompense must be paid, the appropriate maximum number of years and the appropriate maximum share of the CCP's annual profits referred to in the second subparagraph of paragraph 1.

ESMA shall submit those draft regulatory technical standards to the Commission by 12 February 2022.

The Commission is empowered to supplement this Regulation by adopting the regulatory technical standards referred to in this paragraph in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010.

3.2 Conditions for the recompense

3. Under Article 20(1) of CCPRRR a competent authority may require a CCP to compensate clearing members for their losses in a very specific scenario. The recompense may only be required by the competent authority (i) following a non-default event, (ii) where the CCP has applied measures to the value of gains payable to non-defaulting clearing members (i.e. the variation margin gains haircutting, also known and hereafter referred to as 'VMGH'), which go beyond the contractually committed obligations, and (iii) that such measures have allowed the CCP to avoid being placed into resolution. ESMA's mandate under Article 20(2) of CCPRRR is to further specify the conditions of this compensation scheme.

3.2.1 Non-default event

4. In accordance with Article 2(9) of CCPRRR, a non-default event is a "scenario in which losses are incurred by a CCP for any reason other than a default event, including but not limited to, business, custody, investment, legal or operational failures or fraud, including failures resulting from cyber-attacks". The draft RTS presented in this Final Report only covers the situation where a CCP in recovery caused by a non-default event has applied the arrangements and measures to reduce the VMGH payable by the CCP to non-defaulting clearing members set out in its recovery plan.
5. For the avoidance of doubt, a loss may occur from a non-default event at the same time as a default event, but this would not affect the possibility of the competent authority of the CCP to require the CCP to recompense the relevant clearing members in relation to the relevant losses deriving from the application of VMGH measures following the non-default event.

3.2.2 Non-contractually committed losses stemming from VMGH measures

6. As specified under Article 20(1) of CCPRRR, the competent authority may require the CCP to recompense non-defaulting clearing members only where the CCP has applied

VMGH measures, whilst contractually committed losses shall be excluded from the recompense.

7. It is therefore noted that VMGH makes it temporarily possible for CCPs to withhold variation margins that are calculated based on the exposure between the parties as calculated based on the CCP's margin/collateral framework/methodologies and that are due to be returned to the clearing member. Whilst the rulebook or the recovery plan of the CCP may very well regulate *how* VMGH measures are to be applied it is understood that for a VMGH measure to qualify for a possible recompense under Article 20(1) of CCPRRR it should have been provided by the clearing member on a voluntary basis i.e. the clearing member should have consented to the application of VMGH measures at the time of their application. Any obligation on a clearing member to apply VMGH measures would qualify as contractually committed or pre-agreed losses and would not qualify for possible recompense.
8. Hence, the competent authority may only require any potential recompense as referred to in Article 20(1) of CCPRRR and further specified in the draft RTS where the VMGH measures are not contractually pre-agreed between the CCP and the clearing member either in the CCP's internal rules or in a separate agreement with the CCP.

3.2.3 Allowing the CCP to avoid resolution

9. Under Article 20(1) of CCPRRR the recompense may only be required by the competent authority where the measures implemented by the CCP have made the recovery successful, i.e. where the CCP has not entered into resolution. In other words, should the CCP enter into resolution, even after having applied the VMGH measures referred to in Article 20(1) of CCPRRR, the competent authority may not require the CCP to compensate non-defaulting clearing members for their losses.
10. ESMA however notes that the criterion of not entering into a resolution is not further specified, hence there is no sequencing or time limitation to define that the CCP has avoided resolution. The timing of the contributions may though have an impact on any recompense that may be decided to be made to the relevant clearing members and the "order" of recompense to ensure equal treatment if there are several non-default events.

4 Order in which the recompense must be paid

4.1 Background and approach proposed

11. In accordance with Article 20(2) of CCPRRR, the draft RTS should first specify the order in which the recompense shall be paid.
12. In the context of the recompense under Article 20(1) of CCPRRR, it is understood that the "order of payment" refers to the order of priority between multiple non-defaulting

clearing members which have been determined as eligible for compensation, i.e., that meet all the conditions under Article 20(1) of CCPRRR (not being in default, having made a voluntary contribution, losses not contractually committed and the CCP having avoided resolution). The draft RTS should therefore specify the order in which different non-defaulting clearing members that are eligible for recompense (eligible claims) would be entitled to receive cash payments or receive and hold instruments recognising a claim on future profits in relation to the contribution made.

13. ESMA notes that the recompense of the eligible claims to non-defaulting clearing members shall be proportionate to their losses in excess of their contractual commitments. In order to ensure such proportionality, a first approach could therefore be not to specify any order between eligible claims, i.e., all non-defaulting clearing members would be treated equally.
14. However, ESMA considered another approach to reflect an order of payment in the draft RTS subject to consultation. In order to incentivize clearing members to voluntarily contribute, i.e., by agreeing for the CCP to withhold variation margin payments due to the clearing member in order to help the CCP to avoid resolution, an order of priority could be established between all non-defaulting clearing members that contributed based on when they contributed. Under that “first-in / first-out” rule, the competent authority would require the CCP to recompense in priority clearing members for their contributions made on the first three working days following the request from the CCP (senior ranking claims) before any remaining clearing members contributing on the following days. In other words, late contributors would only be recompensed for example where all senior ranking CMs have been repaid in full, where possible.
15. Under that approach for the order of payment, the proposed draft RTS would therefore specify the following:
 - The order of recompense among multiple non-defaulting clearing members entitled to recompense depends on **when** such clearing member contributed i.e. where such contribution is made closer to the request of the CCP following a non-default event, (taking the date of the contribution as reference), such contribution would qualify as a senior ranking contribution and result *in a senior ranking claim*. Recompense shall be made in priority to such clearing members having made a senior ranking contribution and the senior ranking claim shall be recompensated in full before the remaining clearing members, that have voluntarily been subject to a VMGH measures, are subject to recompense.
 - The cash payments / distribution of instruments recognising a claim on future profits **shall be proportional** to the losses identified of each **equally ranked eligible claim** (i.e., senior ranking claims compared to other legitimate claims made by clearing members) by a non-defaulting clearing member; and

- Where the compensation is provided both in cash and instruments recognising a claim on future profits, the split in allocating the different instruments of recompense against eligible claims among non-defaulting clearing members, should be identical.
16. In addition, ESMA notes that under Article 20(1) of CCPRRR the recompense payments to the holders of instruments recognising a claim on future profits shall be taken from the CCPs' future annual profits¹. In order to ensure consistency in the application of the recompense payments, the consultation paper also considered how to define the profits in this context.
 17. For consistency, it was suggested that the profits shall have the same meaning as defined in the applicable accounting framework in the CCP's jurisdiction. However, it shall specify that any amount distributed under a profit-sharing agreement shall be reintegrated in the CCP's profit calculation.

4.2 Feedback from stakeholders

18. Regarding the proposals for an order of payment, despite the relatively small number of answers received (3), two very different views emerged from the respondents.
19. On the one hand, one respondent argued that establishing senior ranking claims between non-defaulting contributing participants is not appropriate, and that any member / client that contributed towards absorbing the CCP's non-default losses should have a pro rata and pari passu claim, without any "seniorisation". The respondent argued that such an order of payment with ranking claims would disincentivize members who might have participated in the loss allocation but may be concerned that they will be "juniorised" because they might not be recompensed first.
20. On the other hand, two respondents agreed that the draft RTS should define senior ranking claims, i.e., that contributions made closer to the non-default event should qualify as a senior ranking contribution and result in a senior ranking claim, that should be compensated in full before other qualifying claims.
21. However, the same respondents noted that the "senior period" (i.e., the maximum amount of time for contributions to be granted ranking claims) should not be specified in the draft RTS, as they argued it should be left at the discretion of the CCP/competent authority when the event occurs. They also agreed that under the proposed order of payment recompense shall be proportionate to the losses between equally ranking claims and that senior ranking claims shall have the same split between cash and instruments as other qualifying claims for recompense.
22. Finally, most respondents agreed with the proposed definition of profits.

¹ Within the limits in terms of number of years and share set out in this draft RTS.

4.3 ESMA's feedback and content of the draft RTS

23. Having considered the answers received, ESMA noted a mixed support for the order of payment distinguishing between senior ranking claims and junior claims.
24. While noting that this approach may incentivize clearing members to contribute as early as possible where a non-default event as referred to in Article 20(1) of CCPRRR occurs, ESMA also considered that the risk of seeing their rights restricted may disincentivise clearing members to contribute at the end of the waterfall, where their contribution would be needed the most to avoid resolution.
25. More specifically, while acknowledging that the mandate requires ESMA to consider and to specify a certain order of payment between clearing members, ESMA noted that the legal mandate does not explicitly allow ESMA to restrict one clearing members rights to receive compensation compared to others, however such a restriction would be the result of any established order in which compensation must be paid. However, in reassessing the order, ESMA suggests keeping the approach proposed under option 1 of the cost-benefit analysis where all clearing members eligible for compensation will be treated equally, *pari passu*. This Option 1 would still provide an order in which recompense must be paid in providing no adjusted order, and would provide a general incentive to contribute, but no adjusted incentive to contribute early in the process.
26. Finally, taking into account the answers to the consultation, ESMA kept the definition of profits unchanged in the proposed final draft RTS.

5 Maximum number of years and maximum share of the CCP's profits

5.1 Background and proposed approach

27. In accordance with Article 20(2) of CCPRRR, the draft RTS shall specify the appropriate maximum number of years from the date of issuance of the instruments recognising a claim on future profits, during which the CCP will need to provide payments to its non-defaulting clearing members that are entitled to recompense.
28. Furthermore, the RTS shall also specify the appropriate maximum share of the CCP's annual profits that could be used for the recompense payments under the instruments providing a claim on the CCP's future profits.
29. When proposing values for the two parameters, ESMA considered the need to strike a balance between guaranteeing the interests of the possessors of the instruments of ownership (the non-defaulting clearing members entitled to recompense payments) and ensuring the CCP can maintain some level of capital reserves, e.g., to meet its investment needs.

30. On the one hand, ESMA noted that contributions through VMGH under Article 20(1) of CCPRRR are made voluntarily by non-defaulting clearing members, so that the CCP may avoid being placed into resolution. Where the competent authority decides to request compensation, the competent authority may want to grant a material share of the profits as recompense, to ensure that non-defaulting clearing members can recoup a substantial amount of their losses. ESMA therefore considered the need to not set too restrictive limits on the maximum share of profits and the maximum number of years where establishing the period over which recompense payments could be made.
31. On the other hand, ESMA notes that the full allocation of a CCP's profits to the recompense contributions, should it span over a large number of years, may jeopardize the viability of the CCP, e.g. by preventing it to make the necessary investments. Similarly, allowing such payments over a long period of time may diminish the attractiveness of the CCP for its shareholders or other investors.

5.1.1 Setting the appropriate maximum share of profits

32. Considering the need to preserve the viability of the CCP while ensuring the non-defaulting clearing members receive recompense, the maximum share of profits set in the RTS should allow CCPs to retain an appropriate share of profits for reinvestment purposes, as retained earnings or reserves.
33. Having considered publicly available financial reporting data, ESMA noted that profits appropriation practices widely differ among EU CCPs.
34. Based on this ESMA concluded that the suitable range would probably be between 60-80%. To follow up on this range ESMA carried out some further assessments to be in a position to suggest a maximum share of the profit. While some CCPs retained all their profits as retained earnings over the last three years, other distributed as much as 90% of profits as dividends (see Table 1, based on available CCPs' data).
35. Considering the above, the proposed draft RTS submitted for consultation suggested to set a maximum share of the CCP's profits at **70%**.

TABLE 1: RETAINED EARNINGS AS A SHARE OF THE CCP'S PROFITS

| CCP | Retained earnings as a share of the CCP's profits | | |
|-----------------|---|------|------|
| | 2019 | 2018 | 2017 |
| BME Clear | 10% | 14% | 10% |
| CC&G | 38% | 5% | 5% |
| ECC* | 0% | 0% | 0% |
| Eurex Clearing* | 0% | 0% | 0% |
| EuroCCP | 100% | 100% | 100% |
| LCH SA | 36% | 0% | 8% |
| OMIClear | 100% | 100% | 100% |

*ECC and Eurex Clearing have both a full profit and loss transfer agreement with their parent company.

5.1.2 Setting the appropriate maximum number of years

36. With regards to the maximum number of years and considering the likelihood of low profitability levels in the first years following a recovery, ESMA noted the importance not to redeem the ownership instruments too early, so that clearing members can recoup a fair amount of their losses.
37. In contrast, ESMA noted that it was important to set a hard limit on the number of years during which recompense payments could be made, in order to preserve the attractiveness of the CCP for external investors. ESMA indeed notes that a high level of indebtedness could diminish the attractiveness of the CCP as a company, and further reduce its ability to raise funds and ensure its viability following the recovery.
38. ESMA therefore suggested in the draft RTS submitted to consultation that the maximum could be set at **10** years.

5.2 Feedback from stakeholders

39. With regard to the proposed values for the maximum number of years and maximum share of profits, four respondents stated that the proposed values were excessively high. They argued that it could endanger the commercial viability and attractiveness of the CCP, taking away resources that should be dedicated to the ongoing risk management and innovation.
40. Instead, one respondent suggested that the proposed values could be modified in order to provide a stronger incentive for the CCPs to pay all their dues.
41. Respondents' suggestions as to how the maximum share of profits and number of years should be set are split into 3 options:
 - A range of 10 to 25% of profits for a maximum of 5 years.
 - A range of 20-30% for a short period, i.e., 3 or 5 years.
 - A sliding scale, with 70% of profits available for the first 10 years, then 50% for years 11 to 20.

5.3 ESMA's feedback and content of the draft RTS

42. When considering the respondents' answers to the consultation, ESMA noted the concerns expressed with regards to both the share of profits that could be allocated to the recompense scheme and the maximum number of years.
43. With regard to the maximum share of profits, ESMA notes the maximum should not be set at 100% of profits, in order to guarantee the CCP's financial soundness.

44. Nevertheless, ESMA also noted that under Article 20(1) of CCPRRR the possibility for the competent authority to impose a significant recompense is envisaged, as it refers to payments “until the loss has been recouped, if possible, in full”. Hence the maximum share of profits should not be set too low, as this could restrain the non-defaulting clearing members from being compensated where the CCP has the financial resources to undertake such recompense.
45. Most importantly, ESMA noted that the draft RTS shall set a maximum amount, but that the exact share of profits may be set by the competent authority when requesting the CCP to recompense the members. Having considered the above, as well as the publicly available figures related to CCPs’ retained earnings, and the concerns expressed by the market, ESMA suggests keeping a relatively high amount of profits as the maximum share of profits, and to set this maximum at **70%** as proposed in the consultation paper.
46. With regard to the maximum number of years, while acknowledging the concerns expressed, it is ESMA’s assessment that reducing the maximum number of years may significantly reduce the possibility for clearing members to recoup a material share of their losses. Similarly, in order not to jeopardise the attractiveness of a CCP, ESMA believes the number of years should not further be extended.
47. Having considered the above, as well as the fact that the draft RTS would only set a maximum value for the number of years, and that the actual number of years of recompense would be left at the discretion of the competent authority, ESMA would suggest keeping the proposed maximum number of years at **10 years**.

6 Annexes

6.1 Annex I - Legislative mandate to develop technical standards

Article 20(2) of CCPRRR states:

ESMA shall develop draft regulatory technical standards to specify the order in which recompense must be paid, the appropriate maximum number of years and the appropriate maximum share of the CCP's annual profits referred to in the second subparagraph of paragraph 1.

ESMA shall submit those draft regulatory technical standards to the Commission by 12 February 2022.

The Commission is empowered to supplement this Regulation by adopting the regulatory technical standards referred to in this paragraph in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010.

6.2 Annex II - Cost-benefit analysis

1. Introduction

Pursuant to the third subparagraph of the second paragraph of Article 20 of CCPRRR the Commission is empowered to adopt a delegated act to supplement the CCPRRR to specify the order in which recompense must be paid, the appropriate maximum number of years and the appropriate maximum share of the CCP's annual profit. ESMA shall develop draft regulatory standards to specify those aspects and ESMA shall submit those draft regulatory technical standards to the Commission by 12 February 2022.

In carrying out a cost benefit analysis on the draft regulatory technical standards it should be noted that:

- The main policy decisions have already been taken under the primary legislation (CCPRRR) and the impact of such policy decisions have already been analysed to some extent by the Impact Assessment by the European Commission²;
- ESMA does not have the power to deviate from its specific mandate provided by the Commission.
- ESMA choices in implementing its mandate should be of a purely technical nature and not contain issues of a policy nature.
- In most circumstances ESMA's policy options are limited to the approach it takes on drafting the technical advice to the Commission in accordance with the mandate.

2. Background

Article 20(1) of CCPRRR introduces a recompense mechanism, where a CCP in recovery caused by a non-default event has applied the arrangements and measures to reduce the value of any gains (i.e., variation margin gains haircutting (VMGH)) payable to non-defaulting clearing members and as a result has not entered into resolution. In that case, the CCP's competent authority may require the CCP to compensate the relevant clearing members for their losses in cash or require the CCP to issue instruments recognising a claim on its future profits. This recompense mechanism only applies to losses not contractually committed in the default management or recovery phases.

3. Options for the approach to be followed

Considering that ESMA's mandate is to develop draft regulatory technical standards to specify the order in which recompense must be paid, the appropriate maximum number of years and the appropriate maximum share of the CCP's annual profits, the only variable on which ESMA can apply and hence the actual option is to set a proportionate and transparent order of priority

² <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=SWD%3A2016%3A0368%3AFIN>

of recompense as between the non-defaulting clearing members and to specify the maximum number of years and maximum share of a CCP's profit and thereby providing the scope and setting the restrictions for when and how competent authorities may require a CCP to recompense the clearing members for their qualified losses.

4. Cost-benefit analysis

a) Order in which recompense must be paid

The below details the different corresponding options for the most suitable approach to be taken by the competent authorities on how to specify the order in which recompense must be paid.

| | |
|--|--|
| Specific objective | Ensuring that where a competent authority decides to require a CCP to recompense the clearing members for their qualified losses this is done in a proportionate and fair manner, considering an order of recompense payments creating a suitable incentive to voluntarily contribute to the CCP. |
| Policy option 1 | To not provide an order in which recompense must be paid. |
| How would this option achieve the objective? | This option would meet the mandate as the proposal would be to actually not propose an order in which recompense must be paid. It would meet the objective, where it is considered that any type of priority proposed may be challenged as introducing restrictions to limit one clearing members rights to receive compensation compared to others and cause arbitrary, and possibly contra-productive, effects in the situation where a CCP would like to ensure that clearing members are interested to voluntarily agree to VMGH measures. |
| Policy option 2 | To provide for a two layered order in which recompense must be paid. |
| How would this option achieve the objective? | This option would meet the mandate as it proposes a priority in which recompense must be paid. It would meet the objective if it is considered that to introduce a senior ranking priority based on when a clearing member decides to contribute is creating correct incentives in the situation where a CCP would like to ensure that clearing members are interested to voluntarily agree to VMGH measures and results in a fair distribution of recompense to clearing members with a legitimate claim. However, this approach could be challenged as introducing restrictions to limit one clearing members rights to receive compensation compared to others. |

| | |
|--|--|
| Policy option 3 | To provide for a multi-layered order in which recompense must be paid. |
| How would this option achieve the objective? | This option would meet the mandate as it proposes a priority in which recompense must be paid. It would meet the objective if it is considered that to introduce a multilateral sequencing in the ranking of priority of claims based on e.g., when a contribution is made and the size of the clearing members contribution would contribute to creating correct incentives in the situation where a CCP would like to ensure that clearing members are interested to voluntarily agree to VMGH measures and results in a fair distribution of recompense to clearing members with a legitimate claim. However, this approach could be challenged as introducing restrictions to limit one clearing member's rights to receive compensation compared to others. |
| Which policy option is the preferred one? | Option 1, given that Options 2 and 3 could be challenged as introducing restrictions to limit one clearing member's rights to receive compensation compared to others, and may be seen as overly complex to implement. |
| Is the policy chosen within the sole responsibility of ESMA? If not, what other body is concerned / needs to be informed or consulted? | ESMA is only providing a technical advice to the Commission which has the delegated responsibility to define which option to choose pursuant to its Delegated Act. |

| | |
|-----------------------------------|--|
| Impacts of the proposed policies: | |
| Policy option 1 | |
| Benefits | No order hence very simple but may not create an incentive as envisaged. |
| Regulator's costs | No costs are envisaged. |
| Compliance costs | For both CCPs and clearing members no compliance costs are envisaged. |
| Policy option 2 | |

| | |
|------------------------|--|
| Benefits | It will provide an incentive to contribute at an early inset of the CCP's decline or in a stressed financial situation without establishing a complex structure of different types of priority claims but will equally probably not provide an incentive to contribute later in the process. |
| Regulator's costs | Very low |
| Compliance costs | For the CCP the compliance costs of this option may entail some costs for the CCP as whilst the rules should be applicable without discretion there would be some cost to establish control measures in form of procedures and reporting and IT tools to register contributions and corresponding claims and control measures in form of procedures and reporting. For the clearing members the compliance costs are very low as the applied priority should be clear. |
| Policy Option 3 | |
| Benefits | It will provide an incentive to contribute at an early inset of the CCP's decline or in a stressed financial situation however, whilst it may in some ways create a well-considered structure based on fairness and incentive it may also raise issues as to proportionality, undue restrictions, result in reduced incentives to contribute later in the process and may be considered as too burdensome to implement bearing in mind the relatively limited scope of this applied order of priority. |
| Regulator's costs | Could be high in managing and monitoring depending on complexity. |
| Compliance costs | For the CCP the compliance costs of this option may entail some significant costs for the CCP as whilst the rules should be applicable without discretion there would be some cost to establish control measures in form of procedures and reporting and IT tools to register contributions and corresponding claims and control measures in form of procedures and reporting. For the clearing members fairly low as it is the CCPs' requirement to apply the order of payments. |

b) Appropriate maximum number of years and share of the CCP’s annual profits

In accordance with Article 20(2) of CCPRRR, the draft RTS shall specify the appropriate maximum number of years from the date of issuance of the instruments recognising a claim on future profits, during which the CCP will need to provide payments to its non-defaulting clearing members that are entitled to recompense. The RTS shall also specify the appropriate maximum share of the CCP’s annual profits that could be used for the recompense payments under the instruments providing a claim on the CCP’s future profits. ESMA has considered the need to strike a balance between guaranteeing the interests of the possessors of the instruments of ownership (the non-defaulting clearing members entitled to recompense payments) and ensuring the CCP can maintain some level of capital reserves, e.g., to meet its investment needs.

Below are detailed the different corresponding policy options on how to determine the appropriate maximum number of years and the appropriate maximum share of the CCP’s annual profit. ESMA notes that as it is the *maximum number of years* and *maximum share* of the CCP’s profit, hence it is for the competent authority to determine the actual number of years and actual share of profit for a certain event where it has been prescribed that the CCP shall recompensate eligible claims of qualifying clearing members. This affects the options set out below as ESMA has not covered options within a range, i.e., where the competent authority decides to apply a long period of time for recompense but with a low share of the CCP’s profit, as this decision would depend on the actual situation and the CCP at hand.

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| <p>Specific objective</p> | <p>Ensuring that where a competent authority decides to require a CCP to recompense the clearing members for their qualified losses this is done in a proportionate and fair manner, ensuring the obligation to recompensate such clearing members with eligible claims are balanced between the interest of clearing members to be compensated and the viability of the CCP as a competitive provider of clearing services.</p> <p>Hence, setting an appropriate limit on the maximum number of years and share of profits should ensure that the recompense payments do not jeopardize the viability of the CCP, nor diminish the attractiveness of the CCP for its shareholders and external investors over a long period.</p> |
| <p>Policy option 1</p> | <p>To set an unlimited maximum number of years and to set the maximum share of the CCP’s annual profits that could be used for the recompense payments to 100%.</p> |
| <p>How would this option achieve the objective?</p> | <p>This option would probably not meet the mandate as to systematically recompense the clearing members in full does not seem envisaged under the regulation, however any limitation is at the cost of the clearing members. This option may though be detrimental to the viability of the CCP if maximum values are</p> |

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| | <p>applied by the competent authority as it could diminish the attractiveness of the CCP for its shareholders and external investors over a long period.</p> <p>To ensure clearing members are incentivised to provide for voluntary support will in the end depend on the viability of the CCP, hence it may be fair to conclude that to balance the interest between clearing members and other stakeholders of the CCP, may be more efficient than ensuring clearing members are fully recompensated.</p> |
| Policy option 2 | To set the maximum number of years to a fairly high number of years, e.g., 10 years and to determine the maximum share of the CCP's annual profits that could be used for the recompense payments also fairly high, e.g., to 60-80%. |
| How would this option achieve the objective? | This option would meet the mandate and would achieve the objective of establishing a proportionate balance between clearing members and other stakeholders of the CCP. |
| Policy option 3 | To set the maximum number of years to a very short period, e.g., 3 years and to determine the maximum share of the CCP's annual profits that could be used for the recompense payments also very low, e.g., 20-30%. leaving a fairly wide scope for distribution of profits. |
| How would this option achieve the objective? | This option may meet the mandate, but it may equally fall short of meeting the requirements that recompense "shall entitle the possessor to receive payments from the CCP on an annual basis until the loss has been recouped, if possible in full, subject to an appropriate maximum number of years from the date of issuance". It would likely be detrimental to the incentive for clearing members to contribute as those narrow ranges would most likely have a negative impact on the recompense level to clearing members. |
| Which policy option is the preferred one? | Option 2, given that Option 1 could be seen as tilting the balance too much in favour of clearing members and Option 3 could be seen as tilting the balance towards ownership interests and investors and may be challenged as not meeting the aim of the regulation. Option 2 would be the most appropriate and proportionate approach to ensure a clear incentive to contribute by clearing members but to balance the interests of clearing members and other stakeholders of the CCP. |

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| <p>Is the policy chosen within the sole responsibility of ESMA? If not, what other body is concerned / needs to be informed or consulted?</p> | <p>ESMA is only providing a technical advice to the Commission which has the responsibility to define which option to choose pursuant to its Delegated Act.</p> |
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| <p>Impacts of the proposed policies:</p> | |
| <p>Policy option 1</p> | |
| <p>Benefits</p> | <p>No limitations hence very simple but may create an unbalanced result and not in the best interest of the CCP, i.e., not meeting the objective of creating a viable CCP.</p> |
| <p>Regulator's costs</p> | <p>Normal costs, as it is envisaged under CCPRRR that the competent authority will have to apply the ranges to the CCP and decide on the number of years and maximum share of profit.</p> |
| <p>Compliance costs</p> | <p>For both CCPs and clearing members no costs are envisaged to comply, but CCP may have high costs in attracting interest in ownership and investments due to the liability to clearing members until repaid.</p> <p>For the clearing members very low as the applied priority should be clear.</p> |
| <p>Policy option 2</p> | |
| <p>Benefits</p> | <p>It is a balanced approach between competing interests of the CCP, with the overall aim to ensure the CCP's viability.</p> |
| <p>Regulator's costs</p> | <p>Normal costs, as it is envisaged under CCPRRR that the competent authority will have to apply the ranges to the CCP and decide on the number of years and maximum share of profit.</p> |
| <p>Compliance costs</p> | <p>For the CCP fairly low as the rules should be applicable without discretion. The CCP may however have somewhat higher costs in attracting interest in ownership and investments due to the liability to clearing members until repaid.</p> |

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| | For the clearing members very low as the applied priority should be clear. |
| Policy Option 3 | |
| Benefits | This Option is beneficial to the CCP to the extent it may assist in ensuring ownership and investments are stable and viable, however, it will most likely result in a loss of incentives to voluntarily assist the CCP in financial difficulties. |
| Regulator's costs | Normal costs, as it is envisaged under CCPRRR that the competent authority will have to apply the ranges to the CCP and decide on the number of years and maximum share of profit. |
| Compliance costs | For the CCP fairly low as the rules should be applicable without discretion. For the clearing members very low as the applied priority should be clear. |



6.3 Annex III - Advice of the Securities and Markets Stakeholder Group

In accordance with Article 16 of the ESMA Regulation, ESMA has requested the advice of the Securities and Markets Stakeholder Group (SMSG). The SMSG has not provided any comment.

6.4 Annex IV –Draft regulatory technical standards specifying the conditions for the recompense under Article 20(1)

COMMISSION DELEGATED REGULATION (EU) No .../..

supplementing Regulation (EU) No 2021/23 of the European Parliament and of the Council with regard to regulatory technical standards specifying the order in which recompense must be paid, the appropriate maximum number of years and the appropriate maximum share of the CCP's annual profits referred to in the second subparagraph of paragraph 1 of Article 20

of []

(text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 2021/23 of the European Parliament and of the Council of 16 December 2020 on a framework for the recovery and resolution of central counterparties, and in particular Article 20(2), third subparagraph thereof,

Whereas:

- (1) In order to ensure a fair and proportional treatment among non-defaulting clearing members eligible for recompense, all eligible non-defaulting clearing members should be recompensed in the same order, and the recompense should be proportional to the losses identified of each non-defaulting clearing member. Also, where there is a split between cash payments and instruments recognising a claim on future profits, the allocation between the cash payments and those instruments should be identical for all recompensed non-defaulting clearing members.
- (2) The setting down of the maximum share of CCP profits from which the recompense is to be paid and the maximum number of years over which it is to be paid should allow the CCP's competent authority, where relevant, to require the CCP to grant a material share of the profits as recompense, to ensure that non-defaulting clearing members can recoup a substantial amount of their losses. At the same time, setting an appropriate limit on the maximum number of years and share of profits should ensure that the recompense payments do not jeopardize the viability of the CCP, nor diminish the attractiveness of the CCP for its shareholders and external investors over a long period.

- (3) This Regulation is based on the draft regulatory technical standards submitted by the European Securities and Markets Authority (ESMA) to the Commission.
- (4) In accordance with Article 10 of Regulation (EU) 1095/2010 of the European Parliament and the Council of 24 November 2010, ESMA has conducted open public consultations on such draft regulatory technical standards, analysed the potential related costs and benefits and requested the advice of the Securities and Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010,

HAS ADOPTED THIS REGULATION:

Article 1

Order in which the recompense shall be paid

1. Where the competent authority of a CCP has required the CCP to recompense clearing members in accordance with Article 20(1) of Regulation (EU) No 2021/23 through cash payments or where it has required the CCP to issue instruments recognising a claim on the future profits of the CCP, all eligible non-defaulting clearing members should be recompensed *pari passu*.
2. Where the compensation referred to in paragraph 1 is done both in cash and through the distribution of instruments recognizing a claim on the CCP's of ownership in future profits, the allocation or split between cash and non-cash recompense shall be identical among eligible non-defaulting clearing members and the total recompense shall be proportional to the losses of each non-defaulting clearing member.
3. Annual payments linked to instruments recognising a claim on the future profits of the CCP shall be taken from the CCP's profits, subject to the limits set in accordance with Articles 2 and 3.
4. For the purposes of Article 20(1) of Regulation (EU) No 2021/23, the CCP's annual profit shall have the same meaning as under the applicable accounting framework for the CCP. Any profit-transfer agreement that may impair the profit level shall be reintegrated in the CCP's profit amount.

Article 2

Maximum share of the CCP's annual profits

Where a CCP is required to make annual recompense payments in accordance with Article 20(1) of Regulation (EU) No 2021/23, such annual recompense payments shall not exceed 70% of the CCP's annual profit for the respective financial year.

Article 3

Maximum number of years

Where a CCP is required to make annual recompense payments in accordance with Article 20(1) of Regulation (EU) No 2021/23, such annual recompense plan of payments shall not exceed 10 years.

Article 4

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President