

Recovery and resolution framework for non-bank institutions

European Parliament resolution of 10 December 2013 on recovery and resolution framework for non-bank institutions (2013/2047(INI))

The European Parliament,

- having regard to the consultative report of July 2012 by the Committee on Payment and Settlement Systems (CPSS) and the International Organisation of Securities Commissions (IOSCO) entitled ‘Recovery and resolution of financial market infrastructures’,
- having regard to the CPSS-IOSCO consultative report of August 2013 entitled ‘Recovery of financial market infrastructures’,
- having regard to the reports of July 2013 by the International Association of Insurance Supervisors (IAIS) entitled ‘Global Systemically Important Insurers: Initial Assessment Methodology’ and ‘Global Systemically Important Insurers: Policy Measures’,
- having regard to the publication of 18 July 2013 by the Financial Stability Board entitled ‘Global systemically important insurers (G-SIIs) and the policy measures that will apply to them’¹,
- having regard to the consultative report of August 2013 by the Financial Stability Board entitled ‘Application of the Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions’,
- having regard to the consultation carried out by the Commission’s services on a possible recovery and resolution framework for financial institutions other than banks,
- having regard to Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (EMIR)²,
- having regard to the Commission’s proposal for a regulation of the European Parliament and of the Council on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC (CSDR),
- having regard to the Commission’s proposal for a directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms (COM(2012)0280) (BRRD), and the report of the Committee on Economic and Monetary Affairs thereon³,
- having regard to Rule 48 of its Rules of Procedure,
- having regard to the report of the Committee on Economic and Monetary Affairs (A7-

¹ http://www.financialstabilityboard.org/publications/r_130718.pdf

² OJ L 201, 27.7.2012, p. 1.

³ A7-0196/2013.

0343/2013),

- A. whereas assessments of financial market infrastructure are now included in the IMF's and World Bank's financial sector assessment programmes;
- B. whereas effective recovery plans and resolution tools are crucial for improving the stability of the non-bank financial sector globally;
- C. whereas financial market infrastructures are organised along widely differing lines; whereas to facilitate the formulation of appropriate plans for recovery and, above all, resolution, it is necessary to make a distinction between them based on organisational complexity, geographical scope and business model;
- D. whereas while EMIR and CSDR aim to reduce systemic risk through well-regulated market infrastructure, there is a possibility of unintended consequences;
- E. whereas while mandatory central clearing contributes positively to decreasing the overall systemic risk of financial markets, it has also increased the concentration of systemic risk in CCPs, recalling that all CCPs are systemically important in their own markets;
- F. whereas the largest clearing members typically participate in more than one CCP, so that if one CCP fails others are also likely to face difficulties;
- G. whereas multiple failures of CCP members will have devastating consequences not only for financial market participants but for the societies concerned as a whole;
- H. whereas the rationale for using a CCP is to reduce counterparty risk by correctly margining products before offering to centrally clear them so that the default of any counterparty does not affect the rest of the market;
- I. whereas risk management processes show that CCPs reduce counterparty risk and uncertainty and prevent contagion;
- J. whereas EMIR does not fully address the risks arising from a CCP wrongly assessing the margin requirements for a whole product class;
- K. whereas CCPs have incentives to apply lower margins, particularly when entering new products or asset classes, in order to attract custom; whereas the effectiveness of default funds segregated by product or asset class is yet to be assessed;
- L. whereas the risks of cross-margining of products (portfolio margining) using ringfencing of assets within the default fund of a CCP are untested, and, therefore, while reducing collateral demand in the short term may reduce costs, the use of cross-margining should not jeopardise the ability of a CCP to correctly manage risk and should recognise the limitations of VaR analytics;
- M. whereas one of the key benefits that clients derive from the clearing member lies in their provision of a firewall against counterparty risk in relation to both the CCP and other clearing members;
- N. whereas the EU's ICSDs are globally systemically important institutions as facilitators of the Eurobond market and currently operate with banking licences;

- O. whereas central clearing has increased the need for collateral management and related services which are now being performed by CSDs as well as custodian banks;
 - P. whereas the impending introduction of Target2Securities has caused CSDs to explore new services;
 - Q. whereas standard insolvency regimes will not provide a complete framework for treatment of client assets should a CSD fail without implementation of the Securities Law Legislation;
 - R. whereas the IAIS reported in July 2013 on ‘Globally Systemic Insurance Institutions’ and concluded that, while the traditional insurance business model has proven considerably less fragile in financial crises than that of banks, nevertheless, large, highly interconnected cross-border insurers, especially those that have significant activities outside traditional underwriting such as credit and investment guarantees, can pose a significant systemic risk; whereas on the basis of the IAIS assessment method the FSB has identified nine large insurers as being systemic, of which five are headquartered in the Union;
 - S. whereas while the systemic risk of an asset manager failing is not as pronounced as for critical market infrastructure, as asset managers’ business models evolve they could become more systemically important, a factor which has been addressed in FSB work on shadow banking;
1. Calls on the Commission to prioritise recovery and resolution of CCPs and of those CSDs which are exposed to credit risk, and, when considering whether it is appropriate to develop similar legislation for other financial institutions, to differentiate appropriately between each type, giving due consideration to those which have the potential to pose systemic risks to the economy;
 2. Emphasises the importance of EU legislation following internationally agreed principles, as agreed in CPSS-IOSCO, FSB and IAIS;
 3. Stresses the importance of clear provisions for a ‘ladder of intervention’ in any recovery provisions for non-bank financial institutions under which competent authorities monitor appropriately designed indicators of financial health and have the power to intervene early in cases of financial stress of an entity and require it to take corrective measures according to a pre-approved recovery plan, in order to stave off the potentially disruptive last resort of putting such an entity into resolution;
 4. Believes that non-bank financial institutions themselves should develop comprehensive and substantive recovery plans that identify critical operations and services and develop strategies and measures necessary to ensure continued provision of critical operations and services, and that these recovery plans should be reviewed by the relevant supervisory authority; considers that the supervisory authority should be able to request changes to the recovery plan and should lead and consult with the resolution authority, which, if different, could make recommendations to the supervisor;
 5. Considers that supervisory authorities should have the power to intervene on financial stability grounds, and to require the implementation of parts of recovery plans which have not yet been activated or take other actions if necessary; the authorities should, however, also be aware of the risk of creating market uncertainty in already stressed circumstances;

6. Takes the view that resolution and supervisory authorities in each country should strive to cooperate and keep each other informed;
7. Believes that for groups with entities in different jurisdictions, a group resolution plan should be agreed between different resolution authorities; such plans should be based on the presumption of cooperation between authorities in different jurisdictions;
8. Considers that resolution measures should differentiate between different services and activities which the financial market infrastructure institution in question is authorised to provide or perform;
9. Stresses the need to avoid any conflicts between the recovery and resolution plans and the existing legislation, in particular the Financial Collateral Arrangements Directive (FCAD) and the European Market Infrastructure Regulation (EMIR), since these could lead to constraints on the recovery and resolution powers for CCPs and CSDs or prevent them from being effective;
10. Underlines the urgent need, in the context of assessing the relevance of specific resolution regimes for market infrastructure, financial institutions and shadow banking entities, for the development of tools for effective near-time monitoring of the stock and flow of financial risk within and across corporate, sectoral and national boundaries in the Union and between the Union and other global regions; urges the Commission to ensure that the relevant data provided under banking, insurance and market infrastructure legislation is used efficiently for this purpose by the ESRB, ESAs and other competent authorities;

CCPs

11. Calls upon the Commission to ensure that CCPs have a default management strategy for all products that are cleared by the CCP as part of a wider recovery plan approved by the supervisor, with a particular focus on those products that are mandated for central clearing, as there is a higher likelihood of risk concentration in these cases;
12. Underlines the importance of monitoring risks to CCPs arising from a concentration of clearing members, and calls on supervisors to inform the EBA of the largest 10 clearing members of each CCP so that risks such as interlinkages, contagion and the potential for failure of more than one CCP at a time can be centrally monitored and assessed;
13. Calls on the Commission to develop tools for measuring CCPs' intraday risk, to ensure that intraday balances held by CCPs with commercial banks for account management and payment services do not exceed predefined limits that could otherwise threaten the functioning of the CCP;
14. Believes that in order to maintain incentives for good governance of CCPs the default waterfall established in EMIR needs to be respected such that the CCP's pre-funded own financial resources are used before any non-defaulting members' default fund contributions;
15. Calls on the Commission to ensure that CCPs act in the general public interest and adopt their business strategies accordingly, in order to significantly reduce the likelihood of triggering recovery and resolution scenarios;

16. Calls on the Commission to recognise that while the aim of ringfencing asset classes within a default fund of a CCP is to limit contagion, it is unclear whether this will be sufficient to prevent such contagion in practice, given that commercial incentives related to cross-margining could increase risk in the system; calls on the Commission to propose further measures in order to minimise this contagion risk;
17. Calls on the Commission to ensure that sound principles are established to govern contractual arrangements between a CCP and its clearing members, as well as how clearing members pass on losses to their clients, in such a way that the clearing member's default fund will have to be exhausted before any losses from a defaulting clearing member can be passed on to the client as part of a transparent loss allocation process;
18. Believes that any contractual arrangements between a CCP and its clearing members should distinguish between losses arising from a member default and those arising from other reasons such as losses incurred as a result of poor investment choices by the CCP; calls on the Commission to ensure that the CCP's risk committee is kept fully apprised of the CCP's investments in order to maintain appropriate oversight; considers that recovery tools such as suspension of dividends and payment of variable remuneration or voluntary restructuring of liabilities through debt-to-equity conversion should be considered the most appropriate tools to be used in these circumstances;
19. Believes that all CCPs should have in place comprehensive recovery arrangements which provide protection over and above the funds and resources required by EMIR; these recovery plans should provide protection against all foreseeable circumstances, and should be included and published as part of the CCP's rules;
20. Asserts that the dividing-line between recovery and resolution in the case of CCPs is when the default waterfall is exhausted, and the loss absorption capacity of the CCP has been depleted; takes the view that at this point the supervisor should actively consider the option of removing the CCP's management board and whether to transfer critical services of the CCP or hand over operational control of the CCP to another provider; believes that the resolution authorities should be given the necessary degree of discretion in assessing the situation, as well as a certain margin of manoeuvre, enabling them to justify their decisions;
21. Believes that in exercising such discretion the resolution authorities should apply the following very specific criteria:
 - (i) where the sustainability of the market financial infrastructure in question is in the process of being, or is already, seriously compromised because of their inability to comply with the prudential requirements applicable;
 - (ii) where there is no alternative to entry into the resolution phase if the situation is to be rectified effectively and without compromising the stability of the financial system;
 - (iii) where a resolution measure is necessary in the public interest insofar as it makes it possible to achieve one or more objectives of the resolution using proportionate means;
22. Stresses the need to treat 'continuity of service' as a key resolution objective;

23. Emphasises that any participation of clearing members in loss allocation before removal of the CCP's management should not involve the money or assets of direct or indirect clients, while the resolution authority, once responsible, may employ resolution tools for loss allocation such as variation margin cutting or refilling of the default fund by the non-defaulting clearing members, following the resolution plan as closely as possible;
24. Believes that if the resolution authority had the ability to impose a stay on early termination rights which would pause the CCP for a maximum period of two days, this could permit the market to correctly re-price the contracts, thus allowing for a more orderly diffusion of risk; the availability and exercise of such a power should be carefully considered so that it is, at a minimum, conditional on the resolution authority determining that imposition of a stay is necessary in the interests of financial stability, having regard to the resolution objectives, interplay with relevant bank or other resolution regimes applicable to clearing members, default and risk management of the CCP and the impact on each of the CCP's markets, clearing participants and financial markets generally; this would necessarily be accompanied by the power to lift the clearing obligation as a last resort after it has at least been examined whether another CCP could provide the clearing in the short term;
25. Acknowledges that CCPs have clearing members from a large number of countries; considers, therefore, that a CCP resolution framework will be effective when it is effective in all the jurisdictions involved; believes that, consequently, national insolvency frameworks have to be updated to accommodate the new European resolution regime;
26. Considers that central counterparties with a banking licence should be subject to a central counterparty-specific regime and not to the proposed bank recovery and resolution regime of the bank recovery and resolution directive (BRR); of particular concern in this sense is the fact that the proposed regime for banks would require them to hold an aggregate amount of debt that can be bailed-in; believes such a power would be inappropriate for central counterparties holding a banking licence because they do not tend to issue such debt instruments;

CSDs

27. Establishes that it is the responsibility of a CSD to ensure that its recovery plan clearly provides for operational continuity in reasonable crisis scenarios so that, even if other parts of its business can be disposed of, its primary settlement function as well as the other core services of the CSD can continue to be performed by the CSD or an existing third party provider, as authorised under CSDR;
28. Calls, if no separate legislative proposal is imminent, for inclusion in the CSDR of a requirement for national competent authorities to ensure the establishment of appropriate recovery and resolution plans in line with FSB and CPSS-IOSCO international standards for all CSDs, including references to the articles of the BRR that should apply to those CSDs operating under a banking licence;
29. Calls on the Member States, in the absence of Securities Law Legislation, to develop and coordinate their existing special administration regimes for CSDs in order to improve certainty as to how operational continuity will be maintained in a crisis, in particular by ensuring access to the registries, records or accounts of the CSD so that the resolution authority or national competent authority is easily able to identify the owners of assets;

30. Calls on the Commission to ensure that the proposal for a recovery and resolution framework for CSDs ensures – as far as possible – the continuity of the CSDs during the recovery and resolution;
31. Calls on the Commission to ensure that the proposal for a recovery and resolution framework for CSDs ensures continuity of the CSDs' legislative environment, in particular by respecting the Settlement Finality Directive, Delivery versus Payment arrangements, the operation of any CSD link, and contracts with critical service providers during the recovery and resolution;

Insurance undertakings

32. Notes that in the EU there is longstanding prudential regulation for insurance; stresses the importance of a consistent and convergent approach by Member States towards the implementation of Solvency II within a reasonable time-frame as set out in Omnibus II; calls for the completion of negotiations on Omnibus II so that levels two and three of Solvency II can be finalised in a timely manner, thus keeping to a minimum the probability of resolution authorities having to step in;
33. Calls on the Commission to closely take into account the IAIS's work on recovery and resolution of insurers, and to consider it within the context of level two of Solvency II, Financial Conglomerates legislation, and the Insurance Mediation Directive and work with international partners to follow the timetable established by the FSB to implement the policy recommendations including requiring systemic insurers to have recovery and resolution plans as well as resolvability assessments in place, enhanced group supervision and higher loss absorbency requirements; recognises that the long-term nature of insurance liabilities, the different timescales, long run-off periods and business nature of insurance compared to banking, along with the tools available to regulators, already provide for efficient resolution practices; believes the focus should therefore be on recovery;
34. Regrets that the IAIS and FSB have postponed the publication of guidelines on the assessment of the systemic status of and policy recommendations for reinsurers until July 2014; calls on the Commission to look carefully at the systemic risk posed by reinsurers, especially with regard to their central role in insurance risk management and their high degree of interconnectedness and poor substitutability;

Asset management

35. Calls on the Commission to assess carefully whether any asset managers should be designated as systemically important, taking into account the scope of their activity and using a comprehensive set of indicators such as: size, business model, geographical scope, risk profile, creditworthiness, and whether or not they trade on their own account and are subject to requirements regarding the segregation of the assets of their clients, as well as other relevant factors;
36. Notes that client assets are segregated and held with custodians, and that, therefore, the ability for these assets to be transferred to another asset manager is a substantial safeguard;
37. Believes that an effective securities law regime could mitigate many of the issues involved in case of failure of a large crossborder asset manager;

Payment systems

38. Calls on the Commission to engage with the relevant international financial supervisors and authorities in order to identify any weaknesses in globally systemically important payment systems and the arrangements in place to ensure continuity of service in the event of failure;
39. Believes that, since payment systems are at the heart of all cash transfers, it is clear that a market perturbation in such a system would have significant spillovers on other financial market actors; notes that the 1998 Settlement Finality Directive already aims to mitigate potential risks in payment systems, but considers that it does not go sufficiently into recovery and resolution, and that specific provisions therefore need to be made in order to allow payments systems to react adequately to adverse circumstances;

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40. Instructs its President to forward this resolution to the Council and the Commission.