

NYSE Euronext's Response to The European Commission services' Consultation on a Possible Recovery and Resolution Framework for Institutions other than Banks

1. NYSE Euronext

- 1.1 NYSE Euronext is a leading global operator of financial markets, a manager of index and other referential data and a provider of innovative trading technologies. NYSE Euronext's exchanges in Europe (Amsterdam, Brussels, Lisbon, London and Paris) and the United States provide for the trading of cash equities, bonds, futures, options, and other Exchange-traded products. NYSE Liffe is the name of NYSE Euronext's European derivatives business and is the world's second largest derivatives business by value of trading. It includes LIFFE Administration and Management ("LIFFE"), which is a regulated market and a Central Counterparty ("CCP").
- 1.2 NYSE Euronext's Identification Number in the Transparency Register is 17804464809-28 and its company address is as follows:

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2. General Comments

- 2.1 NYSE Euronext welcomes the European Commission services' Consultation Document on a Possible Recovery and Resolution Framework for Institutions other than Banks ("the Consultation Document").
- 2.2 At a conceptual level, NYSE Euronext understands the rationale for the Commission services wishing to extend the EU's developing resolution regime from banks to other bodies within the financial sector, particularly in relation to firms which are exposed to counterparty and market risk, and to infrastructures which manage counterparty risk, i.e. CCPs. In relation to CCPs, we note that the Commission services' two principal objectives in extending the regime are to ensure continuity of service, for instance by making provision for the transfer of any failed CCP's services to an alternative CCP or a publicly-owned bridge institution; and by placing the burden on shareholders and clearing members to bear the financial consequences of any CCP failure, rather than any such burden falling on the taxpayer.
- 2.3 Whilst NYSE Euronext would not disagree with the objectives themselves, it does have concerns about some of the practical implications that they may have for the operation of the market and believes that new systemic risks could arise as a result of the resolution regime frustrating CCP operations and dis-incentivising clearing membership. In particular, it would emphasise the following points:
- (a) **Policy Tensions with CCP Operating Standards:** The resolution arrangements contain some inherent tensions with the operating standards which have been promulgated for CCPs internationally and within the EU and, depending on the detailed design of the resolution

arrangements, they may create direct conflicts with those operating standards. This risk is particularly evident in relation to the potential use of “bail-in” resolution powers in respect of a failing CCPs. If those powers were to provide that some or all of the solvent clearing members’ initial and variation margin would be exchanged for equity in the failing CCP in circumstances where the CCP had insufficient resources to manage the default of other clearing members (as has been suggested in the CPSS/IOSCO context), this would directly contradict key provisions of EMIR. For instance, EMIR stipulates that “a CCP shall not use the margins posted by non-defaulting clearing members to cover the losses resulting from the default of another clearing member”¹ and a CCP shall not “expose the non-defaulting clearing members to losses that they cannot anticipate or control”². This type of bail-in approach would also require clearing members to replenish their initial margin which may, in turn, trigger further defaults should clearing members or their clients be unable to do so.

- (b) **Shareholder and Clearing Member Dis-incentives:** Exposing clearing members and CCP shareholders to unquantifiable – and potentially unlimited and open-ended - contingent liabilities requiring them to restore the CCP to financial viability would be a significant disincentive to their willingness to continue to act in those capacities. The business case for a firm maintaining clearing membership is already under strain given the increased costs and reduced revenue streams implicit in post-crisis regulatory requirements, such as the EMIR segregation and margining provisions. Adding an unlimited contingent liability requiring a clearing member to cover losses that it is unable to control or quantify is likely to reduce further the pool of firms which are willing to continue to be clearing members. This, in turn, would lead to a concentration of risk in a smaller number of clearing members, which is likely to be negative in relation to systemic risk management. It would also leave clearing members with a practical problem regarding their capital requirements for counterparty credit purposes which, like the risk they would be facing, would also need to be potentially unlimited.
- (c) **Practicalities of Transferring Business to another CCP:** It will not be straightforward to transfer the business of a failing CCP to an alternative CCP which is viable. CCPs have different legal underpinnings (not only in terms of governing law and jurisdiction, but also in relation to the basis on which contractual arrangements are formed and extinguished, such as novation or open offer), membership requirements and processes, operational interfaces, margin payment and collateral arrangements and account structures (e.g. principal or agency models, and differences in the types of segregation offered by competing CCPs). In addition, a given derivatives product set needs to be supported by bespoke risk and technical processes, which are unlikely to be replicated in a different CCP. The practical consequences of this situation may be that, in most if not all cases, the alternative CCP would be forced to operate the transferred business on a standalone basis for an extended period of time, rather than being able to integrate that business into its existing business at the point of transfer.

NYSE Euronext urges the Commission services to conduct a detailed analysis of the practicalities of transfer in order to test whether the concept is sound.

- (d) **Link with MIFIR “open access” provisions:** NYSE Euronext disagrees with the contention which has been made by some in the context of the ongoing European Council negotiations concerning the “open access” provisions of the Markets in Financial Instruments Regulation

¹ EMIR, Article 45(4) (Default waterfall).

² EMIR, Article 48(2) (Default procedures).

(“MIFIR”)³, that such provisions would facilitate continuity of service and the avoidance of systemic single points of failure. Not only does this contention ignore the practicalities of transferring business to another CCP (as discussed in paragraph 2.3(c) above), it also fails to recognise that the MIFIR open access provisions themselves have the scope to increase systemic risk (for instance, by reducing the existing scope for netting of outstanding financial exposures in listed derivatives) and to introduce new legal and operational risks and uncertainties (e.g. by requiring legally-distinct and non-identical contracts to be treated as fungible).

- (e) **Protections for CCP Directors and Officers:** NYSE Euronext considers that provision should be made to protect directors, officers and staff of a CCP from legal risk (i.e. damages for negligence, contract breach, breach of the provisions of insolvency legislation or other legal liability) associated with actions or inaction pursuant to directions given to them by a resolution authority. In addition, NYSE Euronext considers that complaints against a CCP or regulated market which relate to action or inaction on its part pursuant to such a direction should be excluded from the scope of any formal complaints regimes which those bodies are required to operate. Finally, NYSE Euronext considers that provision should be made to exempt CCPs and regulated markets and their directors, officers and staff from regulatory sanctions associated with action or inaction pursuant to a direction. For example, compliance with a direction may cause a CCP to breach the requirements of EMIR, as explained in paragraph 2.3(a) above.
- (f) **International Coordination and Consistency:** During the summer, CPSS/IOSCO issued a consultative report on the recovery and resolution of financial market infrastructures⁴ and some individual jurisdictions are also currently taking action in this area. It is important that these separate initiatives are taken forward in a coordinated and consistent manner and that sufficient time is taken to design resolution arrangements in which market users and the taxpayer can have confidence. CCPs do not appear to us to present any immediate threat to the interests of taxpayers or users of the market which would warrant precipitous action. Indeed, on the contrary, CCPs provided much needed stability during the financial crisis and continued to perform their key risk management functions in an orderly manner, without recourse to public funds and without any loss to solvent participants in those CCPs. The G20 clearing mandate which will be implemented through EMIR is, of course, intended to increase the range of derivatives which are cleared by CCPs, but this is accompanied by extremely stringent operating standards within EMIR and associated legislation which have been specifically designed to mitigate any resultant increase in risk.

NYSE Euronext would therefore urge the Commission services not to rush the policy making and legislative process in relation to CCP resolution, but instead to play an active and considered role in the development of appropriate policy responses at international level.

- 2.4 To sum up, NYSE Euronext believes that the issues described in paragraph 2.3 need to be given far greater consideration before legislation is contemplated. If they are not, there is a significant danger that the new resolution arrangements will have a de-stabilising effect, which would be a perverse and counter-intuitive outcome.

³ MIFIR, Articles 28-30.

⁴ CPSS IOSCO Consultative Report, “Recovery and Resolution of Financial Market Infrastructures”, dated July 2012.

3. Specific Comments and Answers to the Questions Raised in The Consultation Document

- 3.1 This section of the paper provides answers to the specific questions concerning CCPs and non-CCP market infrastructures which are raised in the Consultation Document. For ease of reference, the section headings and chapter and page references (shown underlined) are those used in the Consultation Document. The questions from the Consultation Document are reproduced in bold italic text. In each case, they are followed by NYSE Euronext's response, which is shown in normal text.

FINANCIAL MARKET INFRASTRUCTURES: CENTRAL COUNTERPARTIES AND CENTRAL SECURITIES DEPOSITORIES (Section 3, pages 10-24)

NYSE Euronext's responses in this section are focused on the impact of a possible resolution regime on CCPs.

3.2 Possible Recovery and Resolution Tools: General (Section 3.2.1(a), pages 15-16)

- 3.2.1 ***Question 1: Do you think that a framework of measures and powers for authorities to resolve CCPs and CSDs is needed at EU level or do you consider that ordinary insolvency law is sufficient?***
- 3.2.2 At a conceptual level, NYSE Euronext understands the rationale for the Commission services wishing to the EU's developing resolution regime from banks to other bodies within the financial sector, particularly in relation to firms which are exposed to counterparty and market risk, and to infrastructures which manage counterparty risk, i.e. CCPs. In relation to CCPs, we note that the Commission services' two principal objectives in extending the regime are to ensure continuity of service, for instance by making provision for the transfer of any failed CCP's services to an alternative CCP or a publicly-owned bridge institution; and by placing the burden on shareholders and clearing members to bear the financial consequences of any CCP failure, rather than any such burden falling on the taxpayer. Whilst NYSE Euronext would not disagree with the objectives themselves, it does have concerns about some of the practical implications that they may have for the operation of the market and believes that new systemic risks could arise as a result of the resolution regime frustrating CCP operations and dis-incentivising clearing membership.
- 3.2.3 ***Question 2: In your view, which scenarios/events might lead to the need to resolve respectively a CCP and a CSD? Which types of scenarios CCPs/CSDs and authorities need to be prepared for which may imply the need for recovery actions if not yet resolved?***
- 3.2.4 The most likely event which could lead to a CCP needing to be resolved would be the default of a number of major clearing members of that CCP over a short period of time. In theory, other events could also lead to a CCP becoming stricken (including operational problems or losses on investments), but these events are far less likely to lead to the need for resolution than the occurrence of multiple simultaneous defaults amongst the CCP's major clearing members.
- 3.2.5 ***Question 3: Do you think that existing rules which may impact CCPs/CSDs resolution (such as provisions on collateral or settlement finality) should be amended to facilitate the implementation of a resolution regime for CCPs/CSDs?***
- 3.2.6 Before considering which, if any, existing rules should be amended, NYSE Euronext believes that the Commission services should consider how the points set out in paragraph 2.3 above can be dealt with in a satisfactory manner.

3.2.7 **Question 4: Do you consider that a common resolution framework applicable to CCPs and CSDs is desirable or do you favour specific regimes by type of FMIs?**

3.2.8 Given that CCPs and CSDs undertake distinct economic functions and operate in a different manner from one another, it would be appropriate to design a specific resolution regime for each of them which reflects those differences.

3.2.9 **Question 5: Do you consider that it should only apply to those FMIs which attain specific thresholds in terms of size, level of interconnectedness and/or degree of substitutability, or to those FMIs that incur particular risks, such as credit and liquidity risks, or that it should apply to all? If the former, what are suitable thresholds in one or more of these respects beyond which FMIs are relevant from a resolution point of view? What would be an appropriate treatment of CSDs that do not incur credit and liquidity risks and those that incur such risks?**

3.2.10 If a resolution regime is to be introduced for CCPs it would be appropriate to apply it to all CCPs. This would be consistent with the scope of application of the EMIR regime, which applies to CCPs irrespective of size.

3.2.11 **Question 6: Regarding FMIs (some CSDs and some CCPs) that are also credit institutions, is the proposed bank recovery and resolution framework sufficient or should something in addition be considered? If so, what should the FMI-specific framework add to the bank recovery and resolution framework? How do you see the interaction between the resolution regime for banks and a specific regime for CCPs/CSDs?**

3.2.12 Whilst a small number of CCPs within the EU have a limited-purpose banking licence as a result of the requirements of domestic legislation, the overwhelming majority of CCPs in the EU are not regulated as credit institutions, nor does EMIR require them to be. Moreover, some of the key aspects of the resolution framework for banks are wholly unsuitable for CCPs. For example, the proposed bail-in resolution powers in relation to banks require that holders of bonds issued by a stricken bank be “bailed-in” by having their debt exchanged for equity in the bank in question. Such a power would be inappropriate and ineffectual in relation to CCPs which hold a limited-purpose banking licence because, like other CCPs, they do not tend to issue bonds. Instead of applying such inappropriate requirements to a subset of CCPs, a tailored regime should be devised for all CCPs. NYSE Euronext would be willing to assist the Commission in the design of such a regime, either on a bilateral basis or in a multilateral context alongside other CCPs.

3.3 Objectives (Section 3.2.1(b), page 16)

3.3.1 **Question 7: Do you agree that the general objective for the resolution of CCPs/CSDs should be continuity of critical services?**

3.3.2 Yes. At a conceptual level, NYSE Euronext understands the rationale for the Commission wishing to extend the EU’s planned resolution regime from banks to other bodies within the financial sector, particularly those which are exposed to counterparty or market risk such as CCPs. We note that the Commission’s two principal objectives in extending the regime are to ensure continuity of service, for instance by making provision for the transfer of any failed CCP’s services to an alternative CCP or a publicly-owned bridge institution; and by placing the burden on shareholders and clearing members to bear the financial consequences of any CCP failure, rather than any such burden falling on the taxpayer. Whilst NYSE Euronext would not disagree with the objectives themselves, it does have concerns about some of the practical implications that they may have for the operation of the market, as explained in paragraph 2.3 above.

- 3.3.3 Whilst NYSE Euronext agrees that the authorities should have the ability to intervene in a stricken CCP, it should be recognised that such intervention is only one option and that it may not be desirable in the circumstances of a particular failure. For example, notwithstanding the policy objective to maintain continuity of service, such a course of action may not be feasible in a given failure (e.g. because of operational and legal complexities or because there is no other CCP which is able or willing to accept a transfer of the business in question). In such a situation, the most prudent course of action from a systemic risk management perspective might be for the CCP to invoice back (i.e. settle) all open market contracts at the price at which they are being held in the books of the CCP, i.e. at the most recent daily settlement price at which variation margin payments had been satisfied. This would usually be the daily settlement price established at the close of business on the business day prior to the day on which the invoicing back was conducted.
- 3.3.4 ***Question 8: Do you agree with the above objectives for the resolution of CCPs/CSDs?***
- 3.3.5 Please see the answer to Question 7.
- 3.3.6 ***Question 9: Which ones are, according to you, the ones that should be prioritized?***
- 3.3.7 Please see the answer to Question 7.
- 3.3.8 ***Question 10: What other objectives are important for CCP resolution?***
- 3.3.9 CCP resolution arrangements should also be designed with the following two objectives in mind:
- (a) They should be as effective as possible, whilst recognising the practical constraints which resolution authorities are likely to face in attempting to resolve a stricken CCP.
 - (b) They should minimise policy tensions with the operating standards promulgated in EMIR.
- 3.3.10 In relation to paragraph 3.3.9(a), it will not be straightforward to transfer the business of a failing CCP to an alternative CCP which is viable. CCPs have different legal underpinnings (not only in terms of governing law and jurisdiction, but also in relation to the basis on which contractual arrangements are formed and extinguished, such as novation or open offer), membership requirements and processes, operational interfaces, margin payment and collateral arrangements and account structures (e.g. principal or agency models, and differences in the types of segregation offered by competing CCPs). In addition, a given derivatives product set needs to be supported by bespoke risk and technical processes, which are unlikely to be replicated in a different CCP. The practical consequences of this situation may be that, in most if not all cases, the alternative CCP would be forced to operate the transferred business on a standalone basis for an extended period of time, rather than being able to integrate that business into its existing business at the point of transfer. Moreover, it is not clear how the resolution authorities would resolve a stricken CCP in a situation in which all other CCPs were also under stress due to general macroeconomic factors coupled with defaults by several major financial institutions which were clearing members of all of the CCPs.
- 3.3.11 Turning to paragraph 3.3.9(b), NYSE Euronext is concerned that the proposed resolution arrangements will contain some inherent tensions with the operating standards which have been promulgated for CCPs internationally and within the EU and, depending on the detailed design of the resolution arrangements, they may create direct conflicts with those operating standards. This risk is particularly evident in relation to the potential use of “bail-in” resolution powers in respect of a failing CCPs. If those powers were to provide that some or all of the solvent clearing members’ initial and variation margin would be exchanged for equity in the failing CCP in circumstances

where the CCP had insufficient resources to manage the default of other clearing members (as has been suggested in the CPSS/IOSCO context), this would directly contradict key provisions of EMIR. For instance, EMIR stipulates that “a CCP shall not use the margins posted by non-defaulting clearing members to cover the losses resulting from the default of another clearing member”⁵ and a CCP shall not “expose the non-defaulting clearing members to losses that they cannot anticipate or control”⁶. This type of bail-in approach would also require clearing members to replenish their initial margin which may, in turn, trigger further defaults should clearing members or their clients be unable to do so.

3.4 Recovery and Resolution Plans (Section 3.2.1(c), page 17)

3.4.1 ***Question 11: What should be the respective roles of FMIs and authorities in the development and execution of recovery plans and resolution plans? Should resolution authorities have the power to request changes in the operation of FMIs in order to ensure resolvability?***

3.4.2 Before considering the respective roles of FMIs and the authorities, NYSE Euronext believes that the Commission services should consider how the points set out in paragraph 2.3 above can be dealt with in a satisfactory manner.

3.4.3 ***Question 12: To what extent do you consider that CCPs/CSDs in cooperation with their users would be able to define efficient recovery and resolution plans on the basis of amendments to their contractual laws?***

3.4.4 The meaning of this question is unclear. If it is asking which aspects of contract law would need to be amended in order to allow CCPs to devise effective recovery and resolution plans, NYSE Euronext believes that, as a pre-requisite, the Commission services should consider how the points set out in paragraph 2.3 above can be dealt with in a satisfactory manner.

3.5 Resolution Triggers (Section 3.2.1(d), pages 17-18)

3.5.1 ***Question 13: Should resolution be triggered when an FMI has reached a point of distress such that there are no realistic prospects of recovery over an appropriate timeframe, when all other intervention measures have been exhausted, and when winding up the institution under normal insolvency proceedings would risk causing financial instability?***

3.5.2 Yes, this is the appropriate trigger for the use of resolution powers. The alternative would be to use a CCP’s failure, or likely failure, to meet its conditions for authorisation under EMIR as the trigger for intervention. If a CCP were on the verge of failing to meet one or more of the conditions for authorisation, its regulator would of course be closely involved with the CCP in managing those circumstances. However, such a likely failure would not automatically justify use by the regulator of its resolution powers. Instead, the appropriate regulatory response would depend on the nature of the failure, whether it was capable of being addressed and rectified by the CCP and what action would be necessary for it to do so and in what timeframe could this be achieved.

3.5.3 In particular, “failure or likely failure to meet its conditions for authorisation” should not be viewed as being synonymous with the CCP being unable to meet its financial obligations. Instead, the regulatory failure could have occurred in a CCP which remains financially viable (for example, the

⁵ EMIR, Article 45(4) (Default waterfall).

⁶ EMIR, Article 48(2) (Default procedures).

failure could relate to the CCP's governance arrangements or stress testing process, which would be capable of being rectified without the need for use of resolution powers).

3.5.4 **Question 14: Should these conditions be refined for FMIs? For example, what would be suitable indicators that could be used for triggering resolution of different FMIs? How would these differ between FMIs?**

3.5.5 Please see the answer to Question 13 in relation to CCPs.

3.5.6 **Question 15: Should there be a framework for authorities to intervene before an FMI meets the conditions for resolution when they could for example amend contractual arrangements and impose additional steps, for example require unactivated parts of recovery plans or contractual loss sharing arrangements to be put into action?**

3.5.7 Please see the answer to Question 13 in relation to CCPs.

3.6 Resolution Powers (Section 3.2.1(e), pages 18-19)

3.6.1 **Question 16: Should resolution authorities of FMIs have the above powers? Should they have further powers to successfully carry out resolution in relation to FMIs? Which ones?**

3.6.2 NYSE Euronext notes that the main thrust of the proposed suite of resolution powers is to enable the resolution authority to transfer the rights and obligations of a failing CCP to another person, with a view to ensuring continuity of service. The Consultation Document discusses this in conceptual terms, but it does not test the transfer concept against practical considerations. As such, NYSE Euronext is concerned that the practicalities of such a transfer have not been considered in sufficient detail (as explained in paragraph 2.3(c) above) and it would urge the Commission services to conduct a more thorough analysis of the practical issues before proceeding further. NYSE Euronext is willing to play an active and constructive role in that process, either on a bilateral basis with the Commission services or in a multilateral context alongside other CCPs.

3.6.3 Moreover, an alternative CCP would be unwilling to assume the business of a failing CCP unless the associated margin cover and default fund contributions were fully intact. If they were made whole prior to the insolvency of the failing CCP (e.g. as a result of additional financial contributions being made by clearing members and/or shareholders of that CCP), thus averting insolvency and ensuring the CCP could continue as a going concern, there would presumably be no need to effect a transfer to another CCP.

3.6.4 **Question 17: Should they be further adapted or specified to the needs of FMI resolution?**

3.6.5 Before adopting resolution powers for CCPs, NYSE Euronext believes it is important for the authorities to consider how the points set out in paragraph 2.3 above can be dealt with in a satisfactory manner.

3.6.6 **Question 18: Do you consider that temporary stay on the exercise of early termination rights could be a relevant tool for FMIs? Under what conditions? How should it apply between interoperating FMIs? How should it be articulated with similar powers to impose temporary stays in the bank resolution framework?**

3.6.7 NYSE Euronext considers that this would be a relevant tool because it is likely that there could be a period of months between FMI insolvency and the point at which an FMI rescue or sale is settled upon by interested parties. Such a stay would assist this process. For interoperating FMIs, the

arrangements may also involve additional regulatory oversight and intervention so as to ensure that risks between FMIs are not imprudently increased or transferred without appropriate controls, as typically interoperability arrangements involve multi-regulatory oversight and co-operation between regulators (sometimes on a cross-border basis).

3.6.8 ***Question 19: Do you consider that a moratorium on payments could be a relevant tool for all FMIs or only some of them? If so, under what conditions?***

3.6.9 A moratorium on payments to and from a CCP whilst its clearing service continued - i.e. whilst it continued to manage outstanding financial exposures - would create additional financial risk because it would involve a suspension of the CCP's margin process which is a key element of its risk management of such outstanding financial exposures. As footnote 29 of the Consultation Documents notes, the FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions notes that such moratoria are inappropriate in relation to CCP payments.

3.7 Resolution Tools (Section 3.2.1(f), pages 19-22)

3.7.1 ***Question 20: Which reorganisation tools could be appropriate for resolving different types of CSDs and CCPs? What would be their advantages and disadvantages?***

3.7.2 NYSE agrees with the comments made in the Consultation Document about the potential difficulties of transferring the business of a stricken CCP to an alternative CCP:

“The transfer of all or part of operations to a healthy market player could be an effective resolution tool for FMIs. This way the continuity of FMI services could be maintained. However, the transfer of certain FMI-functions to other service providers may not be carried out easily and quickly due to the specificities of this sector. Finding a private sector purchaser for an FMI may be more difficult than for a bank due to the fewer number of firms in the industry (e.g. especially OTC derivatives CCPs) and the different nature of FMI's assets and liabilities. Even if a substitute provider is available, operational constraints such as system incompatibility (e.g. IT infrastructures, accounts identification) may be an obstacle to effecting such a transfer”⁷.

3.7.3 As the Consultation Document recognises, the practicalities of resolving a failing CCP by transferring its business to an alternative CCP are likely to be extremely complex. CCPs have different legal underpinnings (not only in terms of governing law and jurisdiction, but also in relation to the basis on which contractual arrangements are formed and extinguished, such as novation or open offer), membership requirements and processes, operational interfaces, margin payment and collateral arrangements and account structures (e.g. principal or agency models, and differences in the types of segregation offered by competing CCPs). In addition, a given derivatives product set needs to be supported by bespoke risk and technical processes, which are unlikely to be replicated in another CCP. NYSE Euronext urges the Commission services to conduct a detailed analysis of the practicalities of transfer in order to test whether the concept is sound in relation to CCPs.

3.7.4 Some proponents of the MIFIR open access provisions have ignored these practical issues and, instead, have argued that transferability of business could be promoted in a resolution scenario if listed derivatives markets adopted the so-called “preferred CCP model”⁸, which operates in some

⁷ Pages 19-20, the Consultation Document.

⁸ The preferred CCP model enables a customer (Customer A) to indicate the CCP at which it wants a transaction to be cleared (CCP 1). If another customer (Customer B) has the same preferred CCP, a transaction between Customers A and B will be cleared at CCP

cash equity markets. However, this argument fails to acknowledge the distinctions between cash equities and listed derivatives. In cash equity markets, transactions are settled on a T+3 basis, whereas derivatives positions typically remain within the CCP for months or years prior to maturity. As a result, if the preferred CCP model were applied to derivatives clearing, it would result in a customer holding gross positions, for an extended period of time, across two different CCPs (i.e. the customer's preferred CCP and the default CCP). This contrasts with the current situation in which derivatives transactions from a particular trading venue are cleared by a single CCP, which is able to net transactions conducted by a particular customer in order to reduce financial exposures. Application of the preferred CCP model would therefore result in the holding of more gross financial exposures, which is counter to the objectives of the G20 to increase the use of netting as a means of reducing systemic risk.

- 3.7.5 That model would also introduce additional costs and inefficiencies, given that clearing members would face duplication in terms of CCP operational arrangements and technical interfaces, as well as non-nettable margin requirements and default fund contributions.
- 3.7.6 The trading venue would be forced to create an order matching algorithm that optimises the clearing destination preference. In contrast with conventional matching algorithms (e.g. time priority or pro-rata to order volume at the best bid or offered price), this methodology would not be transparent as to the prospect of a participant's resting order being filled in some form of equitable priority (i.e. a resting order's position in the "order matching queue" could not be determined as it would depend upon the clearing preferences of incoming orders). It would encourage parties to become members of multiple CCPs solely to maximize their chance of matching any order in the order book. Market access would no longer be determined on the basis of the fair/equitable level playing field envisaged by MIFID I, since priority in the trading process would be structurally tilted by the extraneous characteristic of a party's access to various clearing destinations (favouring large multinational market participants over their smaller competitors).
- 3.7.7 Leaving aside the costs incurred in setting up multiple routes to clearing, there are several significant operational risks that "open access" introduces which undermine the certainty and robustness of the current single route to CCP clearing of exchange-traded derivatives:
 - (a) The incentive of being a clearing member of multiple CCPs in the interest of maximising priority in the trading process has the unintended consequence of reducing the scope for position netting, since buying orders may result in a position at one CCP and selling orders in a position at another CCP. This is clearly undesirable from a risk management perspective and, furthermore, may operationally expose the clearing member to options exercise or making/taking physical delivery when no such exposure was intended; and
 - (b) The current "hard coding" of a single clearing destination is replaced by a system which is open to erroneous input in relation to any individual order. The consequences of this are significant, both in terms of risk and potential cost. As in paragraph 3.2.11(a), position netting may be impeded, exposing the clearing member to particular forms of unwanted risk. This is bad enough in the case of proprietary positions of a clearing member; client positions may be further compromised by a lack of the enhanced segregation and portability arrangements that have been put into place for that client at the intended CCP destination. It should be noted that an error correction by way of redirecting the transaction to the intended CCP would not be possible, as the trade counterparty's interest would have been satisfactorily located at the other CCP.

1. If, however, Customer B has a different preferred CCP (CCP 2), the preference of neither customer will be satisfied and, instead, the transaction will be cleared at a default CCP (CCP 3).

- 3.7.8 **Question 21: Which loss allocation and recapitalization tools could be appropriate for resolving different types of CSDs and CCPs? Would this vary according to different types of possible failures (e.g. those caused by defaulting members, or those caused by operational risks)? What would be their advantages and disadvantages?**
- 3.7.9 This issue requires further discussion and consideration between the Commission services, CCPs and clearing members. It could expose clearing members to unquantifiable – and potentially unlimited and open-ended - contingent liabilities requiring them to restore the CCP to financial viability. This could be a significant dis-incentive to their willingness to continue to act in the capacity of clearing member. The business case for a firm maintaining clearing membership is already under strain given the increased costs and reduced revenue streams implicit in post-crisis regulatory requirements, such as the EMIR segregation and margining provisions. Adding a contingent liability requiring a clearing member to cover losses that it is unable to control or quantify is likely to reduce further the pool of firms which are willing to continue to be clearing members. This, in turn, would lead to a concentration of risk in a smaller number of clearing members, which is likely to be negative in relation to systemic risk management.
- 3.7.10 NYSE Euronext notes that the Consultation Document does not specify the form which such a contingent liability would take, which suggests that thinking on this issue is at an early stage. If the contingent liability were to take the form of “bail-in resolution” arrangements whereby solvent clearing members’ initial and variation margin would - depending on the terms on which it was held by the CCP - be exchanged for equity in the failing CCP in circumstances where the CCP had insufficient resources to manage the default of other clearing members (as has been suggested in the CPSS/IOSCO context), this would directly contradict key provisions of EMIR. For instance, EMIR stipulates that “a CCP shall not use the margins posted by non-defaulting clearing members to cover the losses resulting from the default of another clearing member”⁹ and a CCP shall not “expose the non-defaulting clearing members to losses that they cannot anticipate or control”¹⁰.
- 3.7.11 In addition, if the contingent liability is not subject to a financial cap and is unlimited, the clearing member carrying such a contingent liability would presumably be required by the relevant prudential regulator to hold unlimited capital against such liability. This would appear to be impractical, unless the Commission also plans to introduce tailored derogations within the capital regime. It is unclear whether any such derogations would be compatible with the requirements of Basel III and CRD IV.
- 3.7.12 **Question 22: What other tools would be effective in a CCP/CSD resolution?**
- 3.7.13 The failure of a CCP is extremely unlikely given their inherent risk management culture and the low tolerance to the assumption of undue risk which is exhibited by CCP governing bodies and management; the close and continuous oversight conducted by the regulatory authorities to which they are accountable on an ongoing basis; and the stringent operating standards and exacting detailed requirements promulgated under EMIR. Given this comprehensive set of arrangements, NYSE Euronext does not believe that additional measures are required over and above properly considered and proportionate resolution arrangements which are designed with the specific characteristics of CCPs in mind.

⁹ EMIR, Article 45(4) (Default waterfall).

¹⁰ EMIR, Article 48(2) (Default procedures).

- 3.7.14 Before considering the need for additional resolution powers, NYSE Euronext believes that the Commission services should give further consideration to the application of resolution powers in the context of the particular regulatory requirements upon EU CCPs, given the scope for inconsistency between those requirements and the resolution process; the limited number of sufficiently expert and appropriately authorised private sector buyers which would be capable of assuming the business of systemically important CCPs; and the possibility of systemic interdependence between CCPs, which could involve cross border issues and other complexities.
- 3.7.15 In particular, whilst it may be possible to grant the appropriate regulatory permissions to a bridging institution or a private sector trade buyer, it is not clear how such buyers could obtain de novo or incremental EMIR regulatory authorisation (necessary from 2013 onwards) on an expedited basis. In addition, NYSE Euronext believes that any trade buyer is unlikely to be able to subsume the business of a failing CCP within its own operational framework at the point of transfer (for the reasons explained in paragraph 2.3(c) above). Instead, it would need to continue to operate clearing services on the same (operational, legal and IT) basis as the selling CCP for a lengthy period of time.
- 3.7.16 ***Question 23: Can resolution tools based on contractual arrangements be effective and compatible with existing national insolvency laws?***
- 3.7.17 In our view it is notoriously difficult in the EU to dis-apply national insolvency law by prior contractual agreement and any such contractual solution appears particularly vulnerable to being set aside by the insolvency practitioner of the defaulting party.
- 3.8 Group Resolution (Section 3.2.1(g), page 22)
- 3.8.1 ***Question 24: Do you consider that a resolution regime for FMIs should be applicable to the whole group the FMI is a part of? What specific tools or powers for the resolution authorities should be designed?***
- 3.8.2 It is difficult to see how the CCP resolution regime could apply to the whole corporate group in which a CCP resides unless the corporate group in question consists solely of CCP entities. If, as is the case in most instances, the corporate group also contains other entities, such as exchanges, index providers and trade repositories, it would not be appropriate to apply the CCP resolution regime at group level.
- 3.9 Cross Border Resolution (Section 3.2.1(h), pages 22-23)
- 3.9.1 ***Question 25: In your view, what are the key elements and main challenges to take into account for the smooth resolution of an FMI operating cross-border? What aspects and effects of any divergent insolvency and resolution laws applicable to FMIs and their members are relevant here? Are particular measures needed in the case of interoperable CCPs or CSDs?***
- 3.9.2 National insolvency law approaches vary but it is often the case that insolvency practitioners look to rescue the business as a going concern before realizing value for creditors. Therefore for EU based FMIs, identifying the relevant location of the insolvent FMI for insolvency purposes is key as courts normally recognize company liquidations under the law of company incorporation and co-operate with foreign proceedings further to EU cross border insolvency regulations. Further aspects to consider are where the FMI holds assets, where it has given security over its debts, the location of its workforce and its regulatory footprint and /or banking oversight position.

- 3.9.3 ***Question 26: Do you agree that, within the EU, resolution colleges should be involved in resolution issues of cross-border FMIs?***
- 3.9.4 NYSE Euronext would advocate resolution powers being vested in a single resolution authority per CCP in the interests of timely decision making and action, with any college structure playing a purely advisory or consultative role. If, instead, resolution colleges with decision-making powers were to be established, they would need to be as small and well defined as possible in order to avoid delay in resolving a stricken CCP. In addition, the authorities from the jurisdiction of the stricken CCP should have a majority of the voting power within such a college, for the reasons explained in the answer to the second part of Question 27.
- 3.9.5 ***Question 27: How should the decision-making process be organised to make sure that swift decisions can be taken? Alternatively, do you think that responsibility for resolving FMIs should be centralized at EU-level?***
- 3.9.6 In relation to the first part of the question, please see the answer to Question 26. In relation to the second part, resolution of individual CCPs would need to remain at national level as, ultimately, the national taxpayer may be called upon to help finance the rescue of a stricken CCP (e.g. in circumstances in which the extent of the shortfall in funds within the CCP cannot be met through a recapitalised by shareholders and clearing members alone).
- 3.9.7 ***Question 28: Do you agree that a recognition regime should be defined to enable mutual enforceability of resolution measures?***
- 3.9.8 Yes, this is important given the international nature of shareholding in, and clearing membership of, the EU's main CCPs.
- 3.9.9 ***Question 29: Do you agree that bilateral cooperation agreements should be signed with third countries?***
- 3.9.10 Yes, cross-border cooperation will be important given the international nature of the business of most major CCPs.
- 3.10 Safeguards (Section 3.2.1, pages 23-24)
- 3.10.1 ***Question 30: Do you agree that the resolution of FMIs should observe the hierarchy of claims in insolvency to the extent possible and respect the principle that creditors should not be worse off than in insolvency?***
- 3.10.2 We agree that so far as possible there should be a transparent and known advance position for creditors, but that the smooth close out or continuation of markets and clearing should be the priority.

PAYMENT SYSTEMS AND OTHER NON-BANK FINANCIAL INSTITUTIONS/ENTITIES

- 3.11 Other Non-Bank Financial Institutions
- 3.11.1 ***Question 2: Besides those covered in the previous section of this paper, which other non-bank financial institutions can become systemically relevant and how? Depending on the type of institutions, what are the main channels through which such systemic risks are transmitted or amplified?***

- 3.11.2 Unless it can be demonstrated that the business model of a non-CCP FMI exposes it to financial risks that would not allow an orderly wind-down (including the transfer of business to a previously competing or new entity), there is no pressing need for the regulatory framework to be changed to incorporate special resolution powers. In the case of regulated markets, there are already financial resources requirements under some domestic regulatory regimes which are designed to facilitate, if necessary, an orderly wind-down/transfer of business over a defined period without recourse to resolution powers.
- 3.11.3 ***Question 3: In your view, what could be meaningful thresholds in relation to the factors of size, interconnectedness, leverage, economic importance or any other factor to determine the critical relevance of any other non-bank financial institution?***
- 3.11.4 Please see the answer to Question 2 (paragraph 3.11.2).
- 3.11.5 ***Question 4: Do you think that recovery and resolution tools and powers other than existing insolvency rules should be introduced also for other non-bank financial institutions?***
- 3.11.6 Please see the answer to Question 2 (paragraph 3.11.2).
- 3.11.7 ***Question 5: In your view, what could then be meaningful points of failure at which different types of other non-bank financial institutions could be considered to fulfil the conditions for triggering:***
- (a) The activation of any pre-determined recovery measures; or***
- (b) Intervention by authorities to resolve the entity.***
- 3.11.8 Please see the answer to Question 2 (paragraph 3.11.2).
- 3.11.9 ***Question 6: With respect to possible preventive and preparatory measures:***
- (a) Do existing regulatory frameworks applicable to other non-bank financial institutions provide for sufficient safeguards, in particular with respect to their governance structures, market/counterparty/liquidity risk management, transparency, reporting of relevant information and other etc?***
- (b) Are supervisors equipped with sufficient powers to be able to collect information and monitor the various types of risks existing or building up in the particular non-bank financial sector/institution?***
- (c) Are additional supervisory powers needed to ensure de-risking and prevent overly complex and inter-linked operations?***
- (d) Would recovery and resolution plans be necessary to be introduced for all or only some of these institutions? Why?***
- 3.11.10 Please see the answer to Question 2 (paragraph 3.11.2).
- 3.11.11 ***Question 7: With respect to possible early intervention powers and measures:***
- (a) Do existing regulatory frameworks applicable to other non-bank financial institutions provide for effective early remedial actions of supervisors aimed at correcting solvency or operational problems at an early stage?***

(b) What other early intervention powers could be introduced?

3.11.12 Please see the answer to Question 2 (paragraph 3.11.2).

3.11.13 ***Question 8: With respect to possible resolution measures and tools:***

(a) Should administrative, non-judicial procedures and tools for the restructuring or managed dissolution of other failing non-bank financial institutions be introduced?

(b) Depending on the entity, what could be the appropriate and specific resolution tools to be used? For which institutions are certain resolution tools or techniques not relevant? Why?

3.11.14 Please see the answer to Question 2 (paragraph 3.11.2).

4. Next Steps

- 4.1 NYSE Euronext would welcome the opportunity to discuss the contents of its response to the Consultation Document with the Commission services, particularly if the Commission services require any clarification about the contents of this response. The relevant contact details are set out in section 5.
- 4.2 NYSE Euronext is content for its response to the Consultation Document to be made public.

5. Contact Information

- 5.1 If the Commission services would like to discuss any of the points made in this response it should contact the following:

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