euroclear

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Euroclear response to the Commission's consultation on the technical details of the possible EU framework for bank recovery and resolution

This response is provided on behalf of the Euroclear group of companies ("Euroclear"). Euroclear comprises the International Central Securities Depository ("ICSD") Euroclear Bank ("EB"), based in Brussels, as well as the national central securities depositories ("CSDs") Euroclear Belgium, Euroclear France, Euroclear Nederland, Euroclear UK & Ireland Limited, Euroclear Finland, and Euroclear Sweden. It also includes Xtrakter, a provider of trade matching and transaction reporting services based in the UK.

Euroclear group welcomes and supports the initiative for a common European framework for bank recovery and resolution. As market infrastructures, we support all initiatives that will make the functioning of financial markets more secure and that respect the specific role of these infrastructures.

Euroclear is registered on the European Commission's register of interest representatives (ID number 88290282308-75).

KEY POINTS

1. We would like to highlight that market infrastructures such as CCPs, CSDs and ICSDs play a crucial specialised role in financial markets. The functions of certain market infrastructures (some of which have a banking licence) must be preserved in order to prevent considerable systemic risk. This is certainly the case for the (I)CSDs, for which a simple market exit cannot be considered as a credible option. The specific role of market infrastructures is also recognised by the Commission's legislative initiatives EMIR and the upcoming CSD legislation.
2. The suggested financing arrangements are meant to impose a cost on the "surviving" institutions rather than taxpayers.

   However, we would like to highlight that:

   - "surviving" institutions would be weakened by the consequence of the redistribution of costs related to the resolution of one or a few failing institutions. In a generalised banking crisis, this might exacerbate systemic risk; and
   - low-risk institutions, such as ICSDs, could be penalised if they were subject to such costs. Therefore, we would like to stress that, in relation to contributions to a resolution fund, the Commission should adopt the principle of proportionality, i.e. contributions should be proportionate to the risks incurred.

   We believe that the Commission needs to avoid a situation where banks with very different business models and risk profiles contribute to the resolution fund in a similar manner. For instance, the ICSDs, in addition to complying with

MiFID, CRD and Basel requirements, are also likely to be subject to the future regulatory framework for the CSDs. As single purpose banks, their risks are limited within strict boundaries. Their risk profiles are not comparable with those of commercial banks, for which risk taking is the essence of the business.

3. Euroclear Bank's exposures to its participants or treasury counterparties are generally very short term. Clear thresholds for the notification of material changes in exposures to resolution authorities should be determined (which should be commensurate with the type and volatility of exposures that the relevant institution faces). Otherwise, the institutions would face heavy administrative burdens and the information supplied would be unlikely to help early reaction by relevant authorities.
4. Securities settlement systems and payment systems should be explicitly exempted from both the suspension of payment or delivery obligations and the suspension of close out netting rights.
5. We particularly welcome the European Commission's intention to ensure a number of safeguards related to settlement systems. The proposed provisions of the Settlement Finality Directive (SFD) are indeed highly relevant. We are in favour of complementing the SFD protections with explicit exceptions for operators of settlement systems, so as to avoid undue potential systemic risks.
6. We would like to note that some of the provisions in the Working document should also be looked at from a global perspective. Some provisions that could be implemented in the EU, would be very difficult to be delivered in a cross-border context, for example, if an institution's head office is domiciled outside the European Union (EU), or if it has subsidiaries or branches outside the EU.

ANSWERS TO THE QUESTIONS

Part 1- Scope and Authorities

Question box 2

Question 2a. Do you believe that bank holding companies (that are not themselves credit institutions or investment firms) should be within the scope of the resolution regime?

In the case of Euroclear group, the assets and liabilities, as well as the activities performed by Euroclear Bank are kept separate from the activities of its holding company, Euroclear SA, and from Euroclear S.A.'s other subsidiaries. The parent company performs general management activities and provides overall support functions to all entities of the group. As the overall risk profile of the only entity providing limited purpose banking services is low, and the spread of any risk between entities is contained, we are of the view that the Commission could consider exempting or limiting the application of the resolution regime to the parent company (e.g. with respect to the contribution of the parent company to the resolution fund).

Question box 3 – Resolution authorities

The resolution authorities concerned may also wish to determine one single point of contact with the relevant institution. This would encourage clarity as to expectations and avoid multiple similar requests. The authorities should also share information to ensure that institutions would not be required to provide identical data or information to different authorities.

Part 2 – Supervision, prevention and preparation

A. Supervision

Question box 5 (also applicable to the questions 8 and 21c) - Costs

The high-level description makes any cost estimate particularly difficult. One-off costs would very much depend on the exact requirements of the supervisors.

B. Recovery plans

Question box 6 - Recovery plans

The high-level principles suggested in the Working document are appropriate. The adequacy of the recovery planning should, however, be assessed in light of the results of the stress scenarios. For instance, there is no need to develop highly structured plans covering all possible scenarios, if the company's capital capacity is sufficient to cover the needs of the institution, even under stressed circumstances.

C. Intra-group financial support

Question box 10 & 11 – Intra-group (down-, up- and cross-stream) financial support

We believe that intra-group financial support should not be restricted to loans, guarantees or collateral. The broader the possibilities of intra-group support, the less external support would be required. For instance, the Commission could also consider dividend up- streaming from subsidiaries.

Question box 17 – Supervisors to require an institution to request support

We believe that – provided up- and cross-stream financial support is allowed by company law and by supervisors – the decision of the form of such financial support, should be left to the discretion of the board and management of the relevant group companies. If ever supervisors were to require an institution to request financial support, this should be well documented and be based on facts.

D. Resolution plans

Question box 21 – Requirements for resolution plans

While recovery plans are to be drafted by institutions themselves and reviewed by their supervisors, resolution plans will be written by resolution authorities. We note that recovery and resolution plans are potentially based on similar requirements. When the relevant resolution authority is not the bank's supervisor, the information contained in the recovery plan should be appropriately communicated to the resolution authority and re-used in the resolution plan. If that is not the case, institutions could be required to provide similar information twice, which imposes an unnecessary burden.

The European Commission suggests that the institution notifies "resolution authorities of any subsequent material changes in that information in a timely manner". Such notifications on intra-group exposures and exposures to counterparties might not be that easy to implement. Euroclear Bank is a single-purpose banking institution and uses the banking function to ensure efficient settlement for the market. It therefore has very volatile intra-day and end-of-day exposures. These exposures are very short-term, often

not lasting longer than the next business day. As highlighted in the general points, as a result of this volatility, changes in exposure could need to be reported daily, but such figures would lose their relevance very rapidly. Consequently, we would like to ask the Commission to ensure that clear thresholds are established for such notifications, commensurate with the type and volatility of exposures that the relevant institution is used to face.

Question box 22 – Preparatory and preventative powers

Euroclear considers that the proposed preparatory and preventative powers are sufficient to ensure that all credit institutions can be resolved under the framework proposed. However, we would like to warn the Commission about the potentially negative effect on legal certainty of limiting intra-group guarantees or cross-default provisions. This is especially the case for existing agreements.

Part 4 – Resolution tools and powers

G. Resolution tools, powers, mechanisms and ancillary provisions

Question boxes 42 &43 - Temporary suspension of payment or delivery obligations and temporary suspension of close out netting rights. Exemptions for any classes of counterparty.

Two following elements seem essential to us:

I. It is, in our view, essential that resolution procedures do not lead to a disruption of security interest and other collateral arrangements. More specifically, counterparties who are secured creditors should not be prevented from realising collateral to cover debts which are due and payable – whether or not based on netted positions - under the normal operation of an agreement.

Any delay in exercising collateral rights could create a liquidity risk for the counterparty and lead to an undue market risk on the collateral. In cases where the counterparty is a market infrastructure (at either clearing or settlement level) or, for example, a settlement bank in such infrastructure, we do not believe that such a transfer of risk would be acceptable as it would go counter to the stated objective of reducing risk contagion and ensuring overall financial stability. In the interest of the overall robustness of the market infrastructure, we would, therefore, ask for an exclusion of operators of securities settlement systems designated pursuant to the Settlement Finality Directive.

II. Before deciding on the suspension of payment or delivery obligations, or on the suspension of rights to close-out netting, the potential for systemic disruption (as a consequence of such suspensions) should be properly assessed.

We would like to highlight that any exemption concerning limited suspension of payment or delivery obligations should be aligned with what is proposed for the suspension of close-out netting rights.

If payment or delivery obligations in relation to market infrastructure service provision are suspended, this may put at risk both

- recipients of delivery in payment and settlement systems, and
- the payment and settlement systems themselves.

Securities settlement systems and payment systems should be explicitly exempted from both the suspension of payment or delivery obligations and the suspension of close out netting rights.

Question box 44 - Rights to challenge and judicial review

Based on the systemic character of securities settlement systems' activities, and especially the risk of a domino-effect on other participants due to wrongful decisions/actions taken by resolution authorities, we believe that express provision is needed to ensure securities settlement systems have at all times access to judicial appeal. This should not be limited to a review of the legality of the action, nor should remedies be limited to financial compensation.

H. Safeguards

Question box 50 - Protection of trading clearing and settlement systems

We particularly welcome the European Commission's intention to ensure a number of safeguards related to settlement systems. The proposed provisions of the SFD are indeed highly relevant. In this context, we would like to make the following two comments:

1. It must be clear that the SFD prevails over any legislative provisions in the area of resolution. The hierarchy of two legislative texts which both derogate from customary insolvency rules and both are of *ordre public* nature should not be determined by general rules of interpretation, but be explicitly foreseen;
2. The scope of the SFD is likely to be too narrow to offer adequate protection of all designated systems. Generally, the protections offered by the SFD either relate to transfer orders between participants or to rights and obligations, such as collateral, "in connection with the system". This reflects the objective of the SFD which was different from the crisis management rules currently under discussion. System operators have a number of relationships with counterparties with different roles, some of which fall comfortably within the scope of the SFD. Others relationships, e.g. with cash correspondents, depositories or liquidity providers, may not qualify as easily under the scope of the SFD although they contribute to ensuring the overall functioning of the system. Given these ambiguities, we believe it is preferable to complement the SFD protections with explicit exceptions for operators of settlement systems, so as to avoid undue potential systemic risks.

Part 6 – Financing arrangements

Question box 58 - Financing of the fund

We would like to know what type of additional funding arrangements of the fund will exactly be foreseen. This could have an impact on the overall cost of the resolution fund and therefore on the contribution of individual institutions.

Question box 59 - Calculation

To create a level playing field at the European level it is of importance that the calculation of contributions be harmonised across all Member States.

We believe that the calculation should take into account the risk profile of institutions for the following reasons:

- It would motivate them to strengthen their risk management practices, ultimately reducing the likelihood of failures.
- If it is not risk-based, some banks may perceive the fund as a mutualisation of risks, which would create moral hazard. It might therefore create perverse incentives and increase the overall likelihood of bank failures, which is certainly not the intention of the framework.

In particular, we believe that single-purpose banks, like Euroclear Bank, should not be faced by a disproportionate contribution to the resolution fund. Indeed, their low risk profile makes them relatively unlikely to fail. Euroclear Bank, for example, has never incurred a credit loss to date. We believe that any calculation key for resolution fund contributions should therefore clearly reflect the level of risk that institutions run. If the calculation of the fund is not risk-based, financial positions of relatively safe institutions would be unduly harmed.

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