

Central Counterparty Clearing: Issues for Consideration

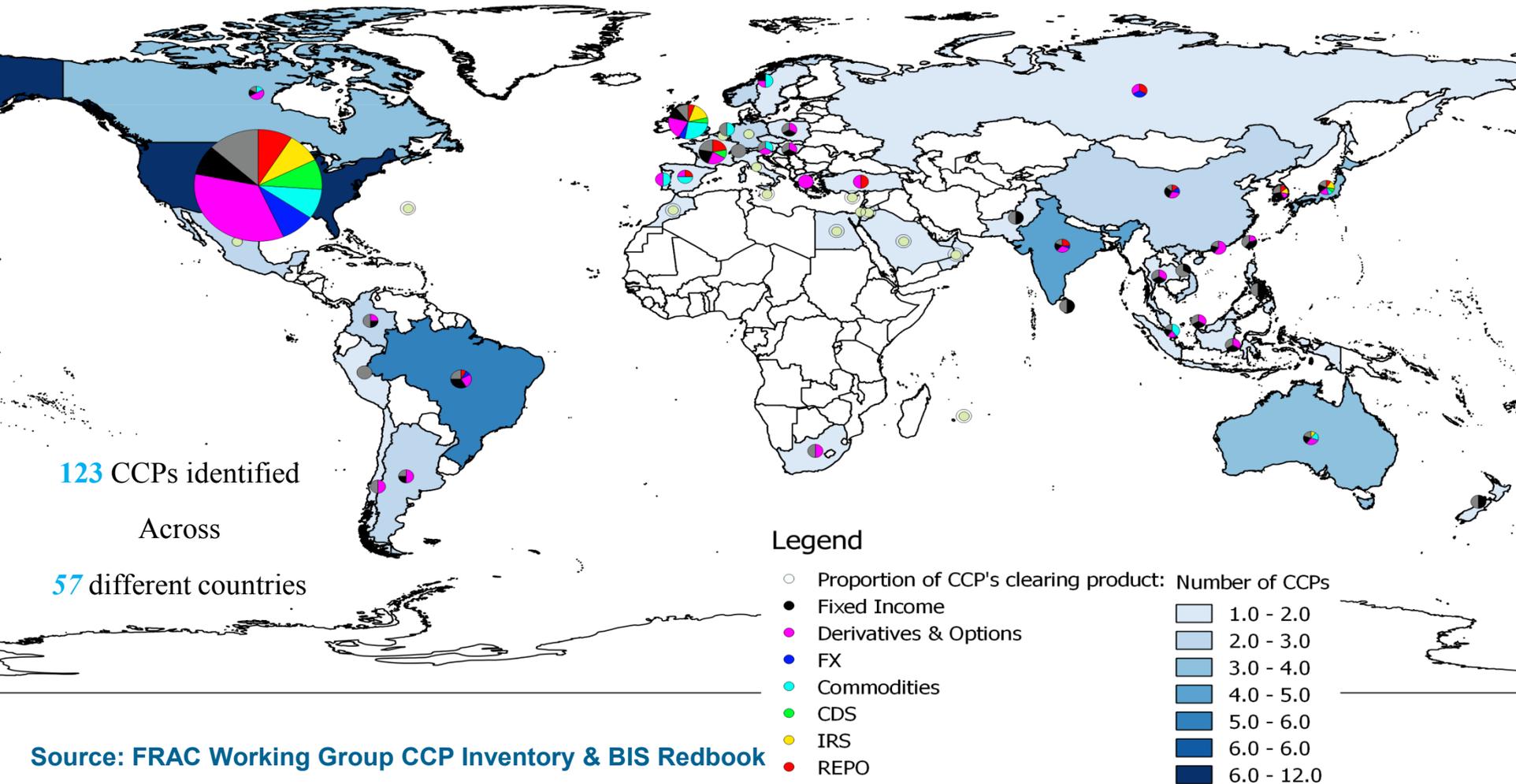
Financial Research Advisory Committee

Financial Services and Risk Management Subcommittee

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CCP's – An Overview

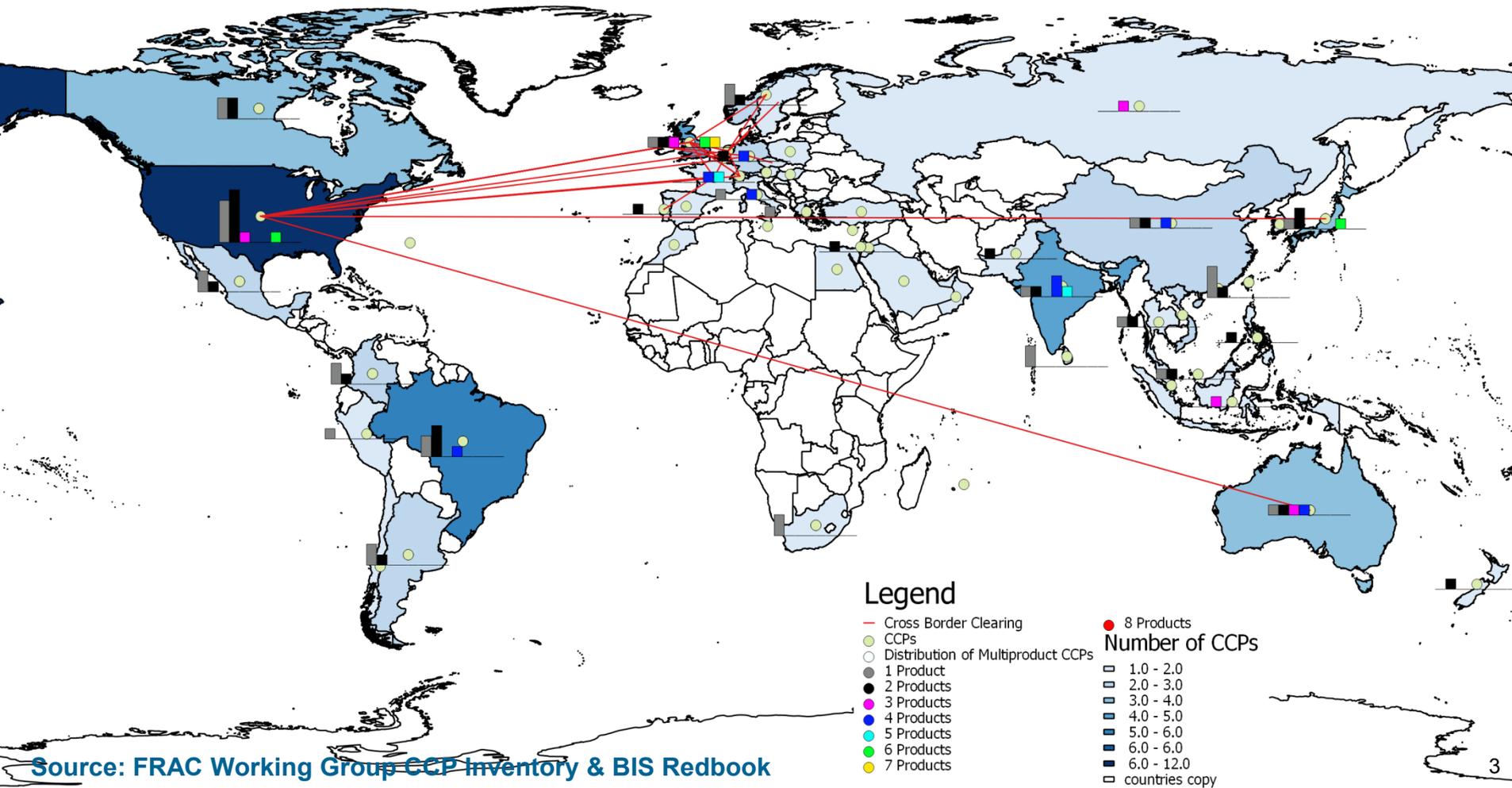
Global map of CCPs: Size indicates relative value of transactions cleared by the average CCP (where available from BIS Redbook)



CCP's - Systemic Relevance

Even as they reduce counterparty risk, CCP's may concentrate the remaining risk.

Global Map of CCPs: Incidence of Cross Border and multiproduct clearing.



CCP's – An Emerging Area of Focus

Despite their increasing significance, CCP risks are not well understood. Some regulators have started to raise concerns:

US – ‘CCPs and regulators need to develop clear and detailed CCP recovery and resolution strategies that are well designed to minimize transmission of the CCP's distress to its clearing members and beyond ‘

-Governor Powell, November 6, 2014

‘As risk concentration increases in the cleared space, CCPs need to have a plan to either recover from severe shocks, or for the CCP's operations to be shutdown in an orderly manner... transparency is critical. Explicit recovery and wind-down plans help avoid an ad hoc response to a systemic event. Explicit plans also mean clearing members get a better picture of exactly how much risk they might face. Clearinghouses should maximize details in order to enhance predictability for clearing members.’

- Mark Wetjen, CFTC Commissioner, Dec 4, 2014:

BOE - TLAC needs to be considered for CCPs as proposed by FSB in addition to ‘writing down operating liabilities through some form of initial margin haircutting should also be considered’

- David Bailey, Director, Financial Market Infrastructure November 24, 2014

CCP's – Governance Issues

Issues to consider include:

- Sizing of tranches of CCP **'Skin in the Game'** to ensure appropriate risk management incentives.
- Assessment of **Adequacy of Disclosure** of margin setting methodology, stress test results, size of total loss resources (including non-member resources), etc.
- Evaluation of the impact of existing **Risk Management and Governance** practices, including: custody arrangements, investment of member collateral, and standards for eligible collateral.
 - To what extent would greater transparency further efficiency?
 - Are best practices identifiable?
- Implementation of **Stress testing** – mandatory, overseen by regulators, globally consistent across CCP's?
- Ensuring the **Liquidity for CCP's** – central bank backing? Capital markets access?
- **Recovery and Resolution**
 - Reflect capital and liquidity structures and incorporate stress test results.
 - Credible basis for operational continuity.
 - Treatment of variation margin and initial margin.
 - Regulatory involvement in recovery versus resolution decision.
 - Consistency across regulatory frameworks and cross border treatment.

CCP's – Developing Product-Specific 'Hot Spots'

CCPs differ in policies, particularly in how they handle different product types and data gaps make it difficult to evaluate these differences

Securities Finance Transactions – potential market impact of different settlement schemes

- A **cleared repo** solution for the buy-side (agent lenders, money market and hedge funds)

vs.

- **Tiered membership** concept – to improve market and security liquidity for assets including treasuries, agencies and equities

Portfolio Margining – contagion risk vs. efficiency

- With other **correlated products**, e.g. stock loan with cash and listed equities

vs.

- Across **multiple products**, e.g. swaps and futures and repo

OTC/Listed Derivatives – regulatory overlap of OTC vs. clearing

- **Increased range of centrally cleared products** (e.g. FX-related products)

vs.

- Intersection and **Interaction with new bilateral OTC Margin** standards

Working Group Recommendations for OFR

Investigating CCP-related issues is important for assessing and reducing the potential for systemically significant risks.

- Undertake a **Comprehensive Survey of recent and ongoing work related to CCP's** and the issues highlighted by the Working Group:
 - Academic work
 - Projects and initiatives led by US regulatory authorities
 - Global initiatives (CFMI / IOSCO)
 - Industry efforts (e.g., US Payments Risk Committee due diligence recommendations)
 - highlight areas for research and for the development of standards
- **Review Data Collection efforts related to CCP's**, domestically and internationally
 - The nature of data currently being collected by different authorities
 - Obstacles to effective data aggregation relating to the role of CCP's and their potential for systemic risk, and make recommendations for addressing these obstacles.
 - Best practices across U.S. CCPs in the areas of systemic importance