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Session 4 – Policy Panel
Risks in (and of) CCPs

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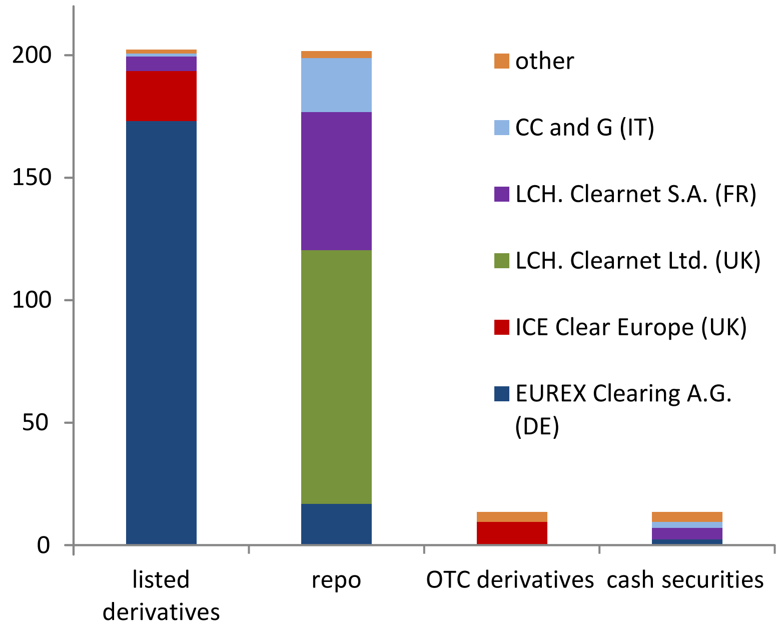
CCPs play an important role especially for listed derivatives and repos...

Notional values of transactions cleared by central counterparties in the EU in 2012 (EUR trillions); sources: BIS, ECB



…but also increasingly for OTC derivatives, in line with G20 objectives

Estimated centrally cleared and non-centrally cleared trades before and after migrating to clearing obligation
Source: FSB 2013, Fifth OTC derivatives progress report
Total gross notional outstanding amounts, USD trillions

		Foreign Exchange	Interest Rate	Credit	Equity	Commodity	Total
Before migration	Centrally cleared	0.0	138.9	3.3	0.1	0.4	142.7
	Non-centrally cleared	67.8	261.8	24.0	6.2	2.5	362.4
	Centrally cleared as % of total	*0%*	*35%*	*12%*	*2%*	*13%*	*28%*
After migration	Centrally cleared	6.6	242.5	12.4	3.6	1.3	268.0
	Non-centrally cleared	61.2	158.2	15.0	2.7	1.6	237.0
	Centrally cleared as % of total	*10%*	*61%*	*45%*	*57%*	*44%*	*53%*
Percentage point increase in central clearing		10 ppt	26 ppt	33 ppt	56 ppt	31 ppt	25 ppt

This development is welcome because central clearing offers specific benefits that bilateral clearing could not:

- It overcomes information asymmetries in heterogeneous markets and thus facilitates risk management
- CCPs offer state-of-the-art risk management that bilateral margin methods may not be able to do
- It enables mutualisation of losses, which does not exist for bilateral trades, and is especially important for handling huge losses
- Perhaps most importantly, it offers multilateral netting and allows for collateral savings to achieve a desired level of risk protection

The rise of central clearing has many benefits, but may also lead to a number of unintended consequences:

- Growing risk concentration in CCPs: systemic consequences of a CCP default could be unprecedented
- Trend towards indirect clearing: risk concentration on a few large dealers acting as GCMs
- Interdependencies: mutualisation creates potential for contagion risk; credit losses and liquidity shortfalls may easily spread following a member's default
- Cross-border frictions: existing differences in regulatory requirements may give rise to regulatory arbitrage and market fragmentation

Moreover, globalisation of clearing poses additional risks:

- Emergence of a few large global CCPs
- Indirect access as the predominant form of access
- Risk concentration on a few super systemically important CCPs
- Risk concentration on a few large dealers acting as GCMs

Key risks that may arise from horizontal integration (CPSS 2010)	
Systemic risk	•CCP is part of a larger entity (too big to fail)* •CCP covers a wide range of markets and participants (possibly cross-border), hence spillover effects may be greater* •Market participants may face increased dependence on a single CCP* •Market participant may not be fully aware of changes to rules and procedures during the integration phase
Reduced benefits from central clearing	•Group may use market power to raise prices* •Group may use market power to restrict new entry* •Merger may lead to higher access requirements, thus limiting access to central clearing
Regulatory frictions	•Merging entities may be subject to different regulatory requirements or legal frameworks* •Particular challenges during integration phase (e.g. insufficient coordination between regulators)
Note: * indicates that similar considerations apply to any multi-product CCP.	

Response to (unintended) consequences of regulatory reforms:

- Need for higher risk management standards and safeguards for global clearing: PFMIs and FSB work
- Greater need for (potential) participants to conduct due diligence: Payments Risk Committee's "Recommendations for Supporting Clearing Member Due Diligence of Central Counterparties"
- Greater effort to be able to handle CCP default: effective recovery and resolution regimes for CCPs under development by CPSS-IOSCO and FSB
- Monitoring of new and increasing risk from market structure developments: FSB and CPSS
- Implementation monitoring of PFMIs may suggest areas where greater granularity and further harmonisation in CCP requirements are needed

Conclusions

- Trend towards more central clearing is welcome as it helps to reduce and manage risks better.
- However, there are a number of downsides, including growing risk concentration in CCPs, redistribution of risks to banks and the rise of new risks through interdependencies and cross-border frictions.
- As such, it is a continuous challenge for CCPs, banks and authorities to address any such new risks.