Known unknowns of central clearing

Benoît Cœuré
Member of the Executive Board
European Central Bank

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1. Effects of central clearing
2. Recovery versus resolution
3. Loss allocation tools
4. Global clearing structures

1. Central clearing – goods and bads

Central clearing	
Effect	By means of
Positive: Better risk management	• Facilitating risk management for users • Removing info asymmetries • Multilateral netting: collateral savings
Uncertain: Risk redistribution and loss allocation	• Mutualisation and ability to deal with risk • (Dis)incentives for central clearing • (Dis)incentives for risk taking
Potentially negative: New risks	• Risk concentration in CCPs • More indirect clearing • Creation of bespoke products to avoid clearing obligation • Risk distribution more difficult to predict

Systemic effect of central clearing

- Central clearing improves risk management and promotes financial stability
- Reforms to promote central clearing: (i) clearing obligation, (ii) margin requirements and (iii) higher capital requirements for uncleared trades
- BIS-led macroeconomic impact assessment shows net benefits of 0.12% of GDP per year from these reforms
- But: systemic effect of risk redistribution is uncertain
- And: mandatory clearing may create new risks
- Overall effect is uncertain
- Success of central clearing depends on the resilience of CCPs

2. Recovery versus resolution

Differences between FMIs and banks

- Higher significance of service continuation
- Few substitutes or alternative providers
- Existence of ex-ante loss allocation rules
- Not all FMIs are exposed to credit risk
- Size and composition of balance sheet
- Mandatory use in some cases

→ **Recovery of CCPs is essential**

Entry into resolution should be possible

- Recovery is not a purpose in itself, but a means to preserve financial stability
- Recovery measures may not be sufficient to return the FMI to viability or could otherwise compromise financial stability
- Participants may avoid CCP and may prefer wind down
- Resolution authorities are in a better position than CCPs to do what is systemically needed in a recovery/resolution situation
- Much will depend on authorities to do the right thing in the moment of crisis

3. Loss allocation tools

Trade-offs in the use of recovery tools

- Recovery tools should be (i) comprehensive, (ii) effective, (iii) controllable, (iv) create appropriate incentives for risk management, and (v) minimise negative impact.
- No individual tool can equally meet all of these criteria because of trade-offs, e.g.:
  i. Uncapped cash calls are comprehensive, but may create disincentives for central clearing
  ii. VM haircutting can be comprehensive and effective (as it reduces pay-outs rather than requiring additional pay ins), but the loss distribution and hence systemic effect is uncertain
  iii. IM haircutting help achieve comprehensiveness, but increases potential for contagion risk
- Optimal design of recovery tools is still under debate and evolving
- Regulatory approach by CPSS-IOSCO is therefore non-prescriptive
- This approach might need to be adapted over time

4. Design of the global clearing structure

Design features of the global clearing structure

- How many CCPs?
- Multi-product or single product CCPs?
- Competitive clearing (several CCPs serving the same trading venue)?
- Links between CCPs? Bilateral or multilateral CCPs?
- What degree of tiering: how much direct/indirect clearing?

Globalisation of clearing – risks and benefits

Benefits	Risks
• Greater scope for netting allow for collateral savings	• Systemic risks as CCPs may become too big to fail and may entail greater risk of contagion
• Lower cost of direct access and using CCPs	• Disincentives for central clearing as market power may increase clearing fees and restrict entry
• Increase in transparency for both regulators and CCPs	• Cross-border regulatory frictions in case of multiple (and inconsistent) national regulations
	• Complex cross-border liquidity provision (in several currencies)