

Progress Report on the CCP Workplan

Introduction

The Basel Committee on Banking Supervision (BCBS), the Committee on Payments and Market Infrastructures (CPMI), the Financial Stability Board (FSB), and the International Organization of Securities Commissions (IOSCO) (the “Committees”) agreed a workplan to coordinate their respective international policy work aimed at enhancing the resilience, recovery planning and resolution of CCPs, and to work in close collaboration. To support these efforts, the Committees also agreed to establish a joint study group to identify, quantify and analyse interdependencies between CCPs and major financial institutions and any resulting systemic implications. The workplan focuses on CCPs that are systemic across multiple jurisdictions.

The Antalya G20 Summit Communiqué asked the FSB to report to Leaders on progress for the September 2016 Summit. Continuous close coordination across the various workstreams will be necessary to ensure that the resulting policies preserve incentives to support the broader financial stability benefits of central clearing.

Much of this work is expected to be undertaken in 2016, with some work extending into 2017. This report summarises the progress made in implementing the work plan and sets out the timelines for expected deliverables.

1. Resilience and recovery

Regulatory requirements for CCPs are stronger today than before the crisis. The CPMI-IOSCO *Principles for financial market infrastructures* (PFMI)¹ provide a comprehensive framework for the resilience and recovery of CCPs. Building on PFMI, the CPMI and IOSCO have undertaken significant work to address the resilience and recovery of CCPs.

Resilience

On 16 August, the CPMI and IOSCO published a report on the assessment of selected CCPs’ implementation of the PFMI with respect to their financial risk management and recovery practices.² The report finds that CCPs have made important and meaningful progress in implementing arrangements consistent with the standards. This report identifies, however, some gaps and shortcomings, and calls for CCPs’ prompt action to address these.

¹ See CPMI and IOSCO, *Principles for financial market infrastructures*, April 2012 (<http://www.bis.org/cpmi/publ/d101a.pdf>).

² See CPMI and IOSCO, *Implementation monitoring of PFMI - Level 3 assessment - Report on the financial risk management and recovery practices of 10 derivatives CCPs*, August 2016 (<http://www.bis.org/cpmi/publ/d148.htm>).

Together with the implementation report, the CPMI and IOSCO published a consultative report that proposes more granular guidance on several key aspects of the PFMI, with a view to further improving the resilience of CCPs, with respect to governance, credit and liquidity stress testing, coverage of financial resources, margin, and a CCP's contributions of its financial resources to losses.³ This proposed guidance benefited from the findings of the implementation monitoring exercise, as well as a detailed stock-taking survey and industry input. The report proposes that CCPs make any necessary changes no later than the end of 2017.

In addition to the proposed further guidance on internal stress testing for CCPs, CPMI–IOSCO has started work on a framework for supervisory stress testing of CCPs.

Recovery

The consultative report also proposes guidance that is intended to facilitate a CCP's development of its recovery plan by building on and reiterating certain aspects of the CPMI–IOSCO's *Recovery of financial market infrastructures*.⁴ This is particularly important as the assessment of CCPs' implementation of the PFMI has shown that a number of the CCPs covered by the assessment have not yet put in place the full set of recovery rules and procedures as stated in the PFMI.

Specifically, the consultative report reiterates that a CCP's recovery plan should include tools that comprehensively and effectively address, among other things, (i) the allocation of losses not caused by participant default, (ii) the allocation of uncovered credit losses and liquidity shortfalls following participant defaults, (iii) the speed of replenishment of depleted financial resources, and (iv) the re-establishment of a matched book following a participant default. In addition, a CCP should test and review its recovery plan.

Expected deliverables and timelines

- The CPMI and IOSCO will conduct in 2017 a follow-up targeted review of CCPs' progress in addressing the most important issues identified by the report in the assessment of selected CCPs' implementation of the PFMI.
- A finalised report on more granular guidance for CCP resilience and recovery is targeted for H1 2017.
- A draft framework for supervisory stress testing is targeted for H1 2017.

2. Resolution

Under the work plan, the FSB made a commitment to “consider the need for, and develop as appropriate, standards or guidance for CCP resolution planning, resolution strategies and resolution tools, including cross-border coordination and recognition of resolution actions”.⁵ These should build on the FSB *Key Attributes of Effective Resolution Regimes for Financial*

³ See CPMI and IOSCO, *Resilience and recovery of central counterparties (CCPs): Further guidance on the PFMI – consultative report*, August 2016 (<http://www.bis.org/cpmi/publ/d149.htm>).

⁴ See CPMI and IOSCO, *Recovery of financial market infrastructures*, October 2014 (<http://www.bis.org/cpmi/publ/d121.pdf>).

⁵ See BCBS–CPMI–FSB–IOSCO, *2015 CCP Workplan*, April 2015 (<http://www.fsb.org/wp-content/uploads/Joint-CCP-Workplan-for-2015-For-Publication.pdf>).

Institutions and the Annex on resolution of FMIs and FMI participants, which already provide standards for a range of powers and tools to resolve a failing CCP and for the development of resolution strategies and plans within cross-border Crisis Management Groups (CMGs), or other equivalent arrangements, and the conduct of resolvability assessments.⁶ In his letter to the G20 Finance Ministers and Central Bank Governors, the FSB Chair made a commitment for high-level guidance on resolution issues relating to CCPs to be published by the time of the Hangzhou Summit.⁷

The FSB has undertaken a comprehensive analysis of the suitability of the resolution powers and tools in different distress scenarios and identified elements of resolution strategies for CCPs, including the cross-border cooperation that are necessary to develop and implement such strategies effectively in a cross-border context. On 16 August the FSB published a discussion note for comment by 17 October 2016 that identifies a set of questions and considerations that are regarded as core to the development of effective resolution strategies and plans for CCPs.⁸ They include the following:

- *The timing of entry into resolution.* Authorities should be able to place a CCP in resolution when the recovery plan and any rules and procedures for loss allocation or recovery measures have failed or are likely to fail to return the CCP to viability or would otherwise be likely to compromise financial stability. Authorities should also consider whether a presumptive point in time for assessing the conditions for entry into resolution can or should be determined and, if so, whether such a presumptive point should be disclosed in advance including to the CCP and its participants.
- *The adequacy of financial resources in resolution.* Authorities should make appropriately prudent assumptions about the quantum of resources needed to achieve an orderly resolution and will need to consider whether additional (*ex ante* or *ex post* funded) resources need to be set aside for resolution or whether planning for timely intervention will suffice to ensure the availability of sufficient funds in resolution.
- *The choice of the appropriate tools to return a CCP to a matched book.* A return to a matched book following the default of a clearing member can be achieved through the forced allocation or tear-up of contracts as well as by means of ‘voluntary’ measures such as auctions or direct sales of positions. Key questions for authorities include the extent to which the choice and application of tools to return to a matched book should be made in line with the CCP rulebook, and whether the resolution authority should have the ability to use tools to restore a CCP to a matched book to also allocate losses.
- *The order for allocating losses in resolution and application of the ‘no creditor worse off’ (NCWO) safeguard.* A key question for authorities to consider is to what extent the resolution strategy should be based on a fixed order of loss allocation (e.g. the order established in the rules of the CCP), and consider the consequences of allocating losses differently in resolution. In allocating losses, authorities need to consider the appropriate

⁶ See FSB, *Key Attributes of Effective Resolution Regimes for Financial Institutions*, October 2014 (http://www.fsb.org/2014/10/r_141015/).

⁷ See FSB, *Chair’s Letter to G20 Ministers and Governors on Financial Reforms – Progress on the Work Plan for the Hangzhou Summit* (<http://www.fsb.org/2016/02/chairs-letter-to-the-g20-finance-ministers-and-central-bank-governors/>).

⁸ See FSB, *Essential Aspects of CCP Resolution Planning Discussion Note*, August 2016 (www.fsb.org/2016/08/essential-aspects-of-ccp-resolution-planning).

“no creditor worse off” counterfactual to assess the losses that participants would have borne had the authorities not intervened.

- *Cross-border cooperation in resolution.* Authorities should consider the nature and scope of their cross-border cooperation arrangements, including the composition of their CMGs, in light of the cross-border cooperation that will be required in a resolution and the resolution actions that may need to be given effect in a cross-border context. CMGs or other equivalent arrangements should be established in a manner consistent with the FMI Annex for all CCPs that are determined to be systemically important in more than one jurisdiction. But cross-border cooperation may need to be broader and authorities need to consider how to engage with other jurisdictions in which the CCP is systemically important but which do not participate in the CMG.
- *The overall effects of the resolution strategy on the incentives of the various stakeholders of the CCPs.* A key question for authorities to consider is whether the resolution strategy and plan provide appropriate incentives for the CCP, its owners, its managers and its participants to avoid resolution and achieve a successful recovery and whether it incentivises good governance and risk management without adversely affecting incentives to clear.

Expected deliverables and timelines

- FSB will publish a proposal for more specific granular guidance on CCP resolution in early 2017, with the aim of finalising the guidance by the G20 Summit in July 2017.

3. Central clearing interdependencies

Macroprudential considerations associated with the interconnections in central clearing, particularly across G-SIBs, have come to the fore. A joint BCBS, CPMI, FSB and IOSCO study group was established in July 2015 to identify, quantify and analyse interdependencies between CCPs and major clearing members and any resulting systemic implications.

The study group launched on 10 August a data collection exercise from around 20 CCPs that aims to identify and quantify interdependencies between CCPs and their direct members, indirect members, investment counterparties, liquidity providers, and other financial institutions. An analysis of these interconnections will be reported to the parent committees in early 2017 and a report will be published following their approval. While this is a bespoke data collection exercise, its results could, over time, inform combined supervisory stress tests across CCPs and their participants to understand vulnerabilities and exposures to common shocks, with implications for resilience, recovery and resolvability.

The bespoke CCP data collection will be complemented with analysis of information collected by the International Data Hub (IDH) at the Bank for International Settlements (BIS),⁹ which collects information from 28 globally active banks on their top 50 counterparty exposures and their top funding providers. In May 2016, representatives from the study group analysed CCP-

⁹ With the implementation of Phase 3 of the FSB Data Gaps Initiative, the FSB (as well as the BIS and International Monetary Fund) can make requests to the Hub Governance Group for access to confidential information stored in the IDH. See FSB, *The Financial Crisis and Information Gaps*, September 2015 (<http://www.fsb.org/2015/09/the-financial-crisis-and-information-gaps-2/>).

related information collected by the IDH. While the information that is currently available is limited,¹⁰ the analysis confirmed that there are large interdependencies between banks and CCPs in terms of exposures (measured as initial margin and default fund contributions) and in terms of their lending to and funding from CCPs. As of July 2016, the IDH will collect more granular information on reporting banks' top 10 CCP exposures, and representatives from the study group will have an opportunity to analyse this data later this year.

Expected deliverables and timelines

- The study group will report the findings from their analysis of the interdependencies in central clearing in early 2017.

4. Impact of other regulatory initiatives on incentives to centrally clear

Market participants have expressed concern that the Basel III leverage ratio framework's treatment of client cleared derivatives transactions has the potential to adversely impact the ability of clearing member banks to provide clearing services. Specifically, these concerns cite that the current approach to measuring the potential future exposure (PFE) of a transaction with a client is excessive because collateral posted as initial margin by the client to the clearing member is not permitted to reduce the clearing member's PFE. The BCBS is carefully considering these concerns. The BCBS has consulted on revisions to the leverage ratio, which proposed a new methodology for measuring derivatives PFE (replacing the Current Exposure Method with a modified version of the standardised approach to counterparty credit risk, or SA-CCR) and sought further evidence and data on the impact of the Basel III leverage ratio on client clearing and on clearing members' business models.¹¹

Data collected on client clearing by the BCBS in the past have shown that recognition of offsets of initial margin received would not result in a significant decrease in clearing members' measured exposures. The BCBS recently collected related data via an additional QIS to assess the impact of initial margin received on clearing members' leverage ratio exposure measures. The BCBS will consider comments received and this additional data in the course of finalising revisions to the Basel III leverage ratio framework.

Preserving incentives to centrally clear (including through the availability of client clearing services) helps support the G20 objective for central clearing of standardised OTC derivatives contracts. At the same time, the leverage ratio is deliberately designed as a non-risk-based measure within the broader suite of reforms supporting the G20 goal of increasing the resilience and loss-absorbing capacity of the banking sector.

Other regulatory reforms are coming online in the coming months (e.g. margin requirements for non-centrally cleared derivatives from September 2016, and capital requirements for banks' exposures to CCPs in January 2017) that can be expected to also affect incentives to centrally clear relative to transacting bilaterally. As well, obligations arising from participation in CCPs

¹⁰ Currently, information about banks' positions with CCPs are available only if the CCP is amongst the reporting banks' top 50 exposures, or is a top funding provider.

¹¹ See BCBS, *Revisions to the Basel III leverage ratio framework – Consultative document*, April 2016 (<http://www.bis.org/bcbs/publ/d365.pdf>).

(including those arising from recovery or resolution planning for CCPs) can also shape incentives in this area.

In 2012, the chairs of the BCBS, CGFS, CPMI, FSB and IOSCO established a Derivatives Assessment Team (DAT) to assess the incentives to centrally clear OTC derivatives resulting from the various standards for capital and margin requirements developed by standard-setting bodies. A report of the DAT's findings was published in October 2014.¹² In light of more recent policy development and ongoing implementation since that report was finalised, a follow-up assessment of central clearing incentives will be undertaken, building on this previous report. This work is expected to commence in the first quarter of 2017.

Expected deliverables and timelines

- The BCBS will finalise its revisions to the design and calibration of the Basel III leverage ratio framework by end-2016.
- A follow-up report by the DAT on central clearing incentives will be prepared by end-2017.

¹² See BIS, *Regulatory reform of over-the-counter derivatives: an assessment of incentives to clear centrally*, October 2014 (<http://www.bis.org/publ/othp21.pdf>).