

**WESTERN HEMISPHERE PAYMENTS AND SECURITIES  
CLEARANCE AND SETTLEMENT INITIATIVE (WHI)  
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**TOPIC 1: Securities Settlement Systems  
and their Interactions with Funds  
Transfer Systems  
Central Counterparties (Introductory Remarks)**



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**CONTENT**



**CPSS-IOSCO Recommendation 4**

- Key issues/Additional issues

**Group of Thirty: Global C&S, Rec. 6**

**Benefits**

- Attributed to multilateral netting
- Provides risk management services

**Risks**

**Risk Management Tools**

**Main Concerns**

**Main Issues to be Considered**

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#### **RECOMMENDATION 4: CENTRAL COUNTERPARTIES**



*“The benefits and costs of a central counterparty should be assessed. Where such a mechanism is introduced, the central counterparty should rigorously control the risks it assumes.”*

##### **Key issues**

- ✓ The balance of the benefits and costs of a CCP should be carefully assessed
- ✓ The legal basis for any netting arrangements should be sound and transparent
- ✓ A CCP should institute risk controls sufficient to withstand severe shocks, including defaults by one or more of its participants
- ✓ Adequacy of resources to absorb financial losses should be monitored

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#### **RECOMMENDATION 4: CENTRAL COUNTERPARTIES**



##### **Additional issues to consider**

- ✓ The recommendation also applies to indemnification arrangements
- ✓ If there is no CCP, the recommendation is observed or not observed depending upon the cost benefit analysis. It does not need to be very extensive for small markets

**CPSS-IOSCO TASK FORCE ON SECURITIES SETTLEMENT SYSTEMS ABOUT “RISK MANAGEMENT STANDARDS FOR CENTRAL COUNTERPARTIES”**

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## **GROUP OF THIRTY, RECOMMENDATION 6**



### **Expand the use of central counterparties**

*“Market participants and relevant public institutions should collaborate to assess the potential substantial risk reduction and efficiency improvements of using a central counterparty. These benefits are expected to outweigh their costs in most markets. Where this is so, market participants should seek either to use the services of an existing central counterparty or to establish one of their own, whichever has the better risk, cost, and benefit profile.”*

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## **BENEFITS**



### **Attributed to multilateral netting**

- Reduction in the number of settlements
- Reduction in individual contractual obligations
- May help reduce the margin required to collateralize current and potential future credit exposures
- May help to reduce the capital required to support participant's trading activity
- Helps to sustain anonymity where trade execution process itself is anonymous

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## **BENEFITS**



### Provides risk management services

- Replaces exposures to multiple counterparties with exposure to a single counterparty
- No worry about the creditworthiness of counterpart in transactions, only of single counterparty
- Does not eliminate counterparty credit risk, but redistribute it much more efficiently than market participants could do in isolation

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## **RISKS AND RISK MANAGEMENT TOOLS**



### ➤ **Risks**

- Legal and technical risks (not specific to CCPs but higher potential systemic impact)
- Principal risk (reduction but concentration)
- Replacement cost risks (not specific to CCPs but higher potential systemic impact)

### ➤ **Risk management tools**

- Financial and operational requirements (to minimize probability of failure of a market participant)
- Margins (to minimize the loss if a participants fails)
- Limit build-up of exposures by means of periodic settlement of positions

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## MAIN CONCERNS



- Concentration of risk
- Moral hazard (too big to fail risk)
- Information asymmetry is reduced but only if CCP is perceived to be solvent
- Competition between CCPs could negatively affect risk management standards
- A single CCP would maximise externalities and economies of scale but could produce potential inefficiencies (lack of innovation). Need of appropriate governance rules
- Contagion effects (cross-process, cross-products, cross currencies)

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## MAIN ISSUES TO BE CONSIDERED



- Legal Framework
- Participation Requirements
- Understanding Risks
- Novation
- Settlement
- Default Procedures
- Risk Controls
  - Margins/Guarantee fund/Loss Sharing
- Governance
- Operational Risk
- Regulatory Reporting

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