



5 July 2017

Cover note to the CPMI-IOSCO report on the *Resilience of central counterparties (CCPs): Further guidance on the PFMI*

Background

The Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) (together, the “Committees”) are today publishing further guidance on the principles and key considerations in the *Principles for financial market infrastructures* (PFMI) regarding financial risk management for CCPs. This builds on a consultative report that was published on 16 August 2016 (www.bis.org/cpmi/publ/d149.pdf and www.iosco.org/library/pubdocs/pdf/IOSCOPD539.pdf).

Scope and purpose of the guidance

Consistent with the priorities regarding CCP resilience identified in the joint CCP workplan of the Financial Stability Board (FSB), the CPMI, IOSCO and the Basel Committee on Banking Supervision,¹ this report is intended to improve the resilience of CCPs by providing guidance on the principles and key considerations in the PFMI regarding financial risk management for CCPs.² The report focuses on five key aspects of a CCP’s financial risk management framework: governance, stress testing for both credit and liquidity exposures, coverage, margin, and a CCP’s contribution of its financial resources to losses.

A CCP’s governance arrangements play an important role in ensuring its overall resilience, and the report further elaborates on the responsibility of the board in this process. The report also outlines guidance on the rigour of the credit and liquidity stress tests expected in the PFMI, as appropriate to the systemic importance of CCPs. The guidance on coverage is intended to strengthen a CCP’s observance of Principles 4 and 7 of the PFMI in setting and maintaining on an ongoing basis the required level of resources through its credit and liquidity risk stress testing practices. The guidance on margin systems is intended to assist CCPs in their ongoing efforts to implement and maintain margin systems that are effective in addressing the risks and particular attributes of each product, portfolio and market served. Finally, the report provides further guidance for CCPs on determining an appropriate contribution of own resources towards losses resulting from a participant default and custody and investment of participant assets.

The CPMI and IOSCO note that the detail and granularity of the guidance should be understood in the context of the principles-based approach reflected in the PFMI, which

¹ Available at www.bis.org/cpmi/publ/d134b.pdf.

² While the guidance included in this report is intended explicitly for use by CCPs, some of it may be relevant and useful to other types of FMIs.

recognises CCPs' differing organisations, functions and designs, and the different ways to achieve a particular result.³ This report should be read in conjunction with the relevant principles, key considerations and explanatory notes in the PFMI.⁴ The guidance provides clarity on an acceptable way – although it does not prescribe what is necessarily the only way – of observing the PFMI. Each CCP, in conjunction with the authorities responsible for its regulation, supervision and oversight, should carefully take into account the guidance in this report when developing its approach to observing the PFMI.

Inputs to the report

In developing this guidance, the CPMI and IOSCO considered input from:

1. Industry workshops (conducted both before and during the consultation).
2. Papers submitted by industry groups.
3. A stocktake of current CCP risk management practices in place at over 30 CCPs clearing securities and derivatives products in exchange-traded and OTC markets, representing a wide range of geographic locations, sizes, organisational structures, ownership structures and markets and covering: (i) credit and liquidity stress testing; (ii) margin practices; (iii) prefunded loss absorption capacity or coverage; (iv) CCPs' contribution of financial resources to losses due to participant default as well as to non-default-related losses; and (v) recovery planning. While a separate survey on governance practices was not conducted, governance issues emerged as a common theme in the responses to the surveys as well as in the workshops.
4. Findings from the Committees' Level 3 assessment of financial risk management practices for a selected group of CCPs.
5. Comments submitted in response to the consultative report on resilience and recovery of central counterparties (www.bis.org/cpmi/publ/comments/d149/overview.htm and http://www.iosco.org/publications/?subsection=public_comment_letters).

The Committees would like to express appreciation to the industry participants in this process, who responded to the Committees' CCP surveys and provided detailed and thoughtful comments, on schedules that were particularly demanding.

Main changes of the report in response to the public consultation

Some of the main issues raised with regard the consultative report, which have been clarified/revised in the report are outlined below.

³ See paragraph 1.2 of the PFMI.

⁴ See paragraph 1.36 of the PFMI.



Governance

In response to comments, the report clarifies that, while the board of directors has ultimate responsibility for establishing a risk management framework and for the effectiveness of its implementation, the board is not expected to itself implement the risk management framework or to carry out the day-to-day management of risks. Rather, in discharging its ultimate responsibility over risk management matters, the board should work closely with the CCP's management. More specifically, the board is itself responsible for: (i) carefully overseeing, monitoring and evaluating management's implementation of the risk management framework; (ii) taking appropriate steps to ensure that management is performing risk management tasks properly and effectively; (iii) ensuring that processes are in place for effective and timely communication, reporting and information flow between management and the board; (iv) communicating with management about risk management processes; and (v) when assessing the risk-management framework, appropriately challenging management to demonstrate the effectiveness of risk management processes.

Also in response to extensive comments from stakeholders, the report provides some additional clarity on the mechanisms for feedback. Regarding disclosure for feedback purposes, the approach followed in the report is to focus on desirable outcomes from disclosure and to provide some additional – non-exhaustive – examples of specific aspects of the risk management framework that would benefit from additional transparency, subject to certain safeguards. For example, the guidance calls upon CCPs to provide sufficient detailed information on the CCP's margin system and stress testing framework to participants and other relevant stakeholders to permit them to understand these aspects of the CCPs' risk management framework and provide effective feedback and challenge. This includes information on the supporting rationale for key decisions and sufficient information to support the replicability of margin requirements.

Stress testing

A number of commenters called for a definition of "extreme but plausible". The report emphasises that the aim of the guidance is to elaborate on key matters that CCPs should take into account in establishing their stress testing frameworks, and not to provide a definition. Moreover, additional clarification has been provided in a number of areas; for instance, additional detail has been provided on setting the stressed period of risk (SPOR), including to note that a CCP should consider extending the SPOR or applying other methods to take account of the potential cost of liquidating portfolios that have concentrated positions. The final guidance also provides alternative techniques for analysing stress testing scenarios, models and underlying parameters and assumptions.

Margin

The guidance on margin was also revised in a number of areas in the light of feedback from the consultation. For instance, the report elaborates on the need to clearly articulate the basis of and rationale for a CCP's policy in respect of margin add-ons and the need for appropriate governance and review of the conceptual soundness of its framework for setting add-on charges. The final report also clarifies expectations for CCPs' valuation models and procedures for addressing circumstances in which pricing data are not readily available and reliable, and provides some additional granularity on model backtesting. Finally, the report clarifies that CCPs should consider the potential effect on participants' liquidity positions and market liquidity in designing their operational arrangements for collecting variation margin intraday.



Implementation timeline

Although this guidance does not impose additional standards on CCPs or authorities beyond those in the PFMI, a CCP may need to make changes to its rules, procedures, governance arrangements and risk management framework in order for its practices to be consistent with the guidance. The relevant authority may also determine that it is necessary to make changes to its regulatory framework. As already noted in the consultative report, CCPs should promptly identify any areas where changes are necessary, and address them as expeditiously as practicable, so that implementation of the necessary changes is completed no later than the end of 2017.⁵

Further work

This report does not address recovery planning, which was included in the consultative report. Recovery planning is addressed separately via revisions to the 2014 report on *Recovery of financial market infrastructures* (the 2014 recovery guidance⁶).⁷ The recovery-related comments received on the consultative report on CCP resilience and recovery were carefully considered in the process of revising the 2014 recovery guidance. It remains important that CCPs maintain recovery plans consistent with the PFMI and the 2014 recovery guidance.

Another useful complement to this guidance is supervisory stress testing, particularly in considering the collective response of multiple CCPs to the same stress event or events. The CPMI and IOSCO are currently developing a framework for supervisory stress testing.⁸

During the market consultation, many conflicting comments were received on the need for additional and more detailed disclosure to support participants and other entities in understanding and managing their risks vis-à-vis CCPs. Although it is acknowledged that further guidance on disclosures to facilitate effective feedback on the CCP risk management framework included in this report may also enhance the information available to participants and other entities for due diligence purposes, the CPMI and IOSCO intend to assess the need for further work on disclosure-related aspects of the PFMI.

⁵ The consultative report also noted that a number of gaps and shortcomings had been identified in at least some CCPs' implementation measures through the stocktaking exercise and through the Level 3 assessment. In two areas in particular, the consultative report noted that the CCP and its supervisors, regulators and overseers should consider these gaps and shortcomings to be serious issues of concern that warrant immediate action and that should be addressed with the highest priority. One area was recovery planning, where a number of CCPs had not yet put in place the full set of recovery rules and procedures as required under the PFMI. The other area was credit and liquidity risk coverage, where a number of CCPs had not yet put in place policies and procedures sufficient to ensure that they maintain the required level of financial resources on an ongoing basis. In addition, some CCPs did not include sufficient liquidity-specific scenarios in their stress-testing frameworks. Consistent with the consultative report, the Committees are currently conducting a supplementary Level 3 assessment of progress in these areas as of 31 December 2016.

⁶ See www.bis.org/cpmi/publ/d121.pdf and www.iosco.org/library/pubdocs/pdf/IOSCOPD455.pdf

⁷ The CPMI and IOSCO published on 5 July 2017 a revised report on *Recovery of financial market infrastructures*. See [CPMI](#) and [IOSCO](#). In addition, the FSB published on 5 July 2017 the final guidance on CCP Resolution. See [FSB](#).

⁸ A consultative report on supervisory stress testing was published by CPMI-IOSCO on 28 June 2017. See www.bis.org/cpmi/publ/d161.htm and www.iosco.org/library/pubdocs/pdf/IOSCOPD566.pdf.