

Cover note to the CPMI-IOSCO discussion paper on central counterparty practices on non-default losses

Background

The Bank for International Settlements' Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) (together, the "Committees") are today publishing for public comment a discussion paper on central counterparty (CCP) practices to address potential losses arising from non-default events (ie non-default losses or NDLS).

Scope and purpose of the discussion paper

The purpose of this discussion paper is to facilitate the sharing of existing practices by CCPs with respect to managing NDLS, in particular in the context of recovery or orderly wind-down. It is informed by the current practices at various CCPs.

The paper is intended to advance industry efforts and foster dialogue on the key concepts and processes used by CCPs in four areas:

1. developing methodologies and practices for: (a) identifying scenarios from which NDLS may occur (NDL scenarios); (b) quantifying potential NDLS; and (c) assessing the sufficiency of resources and tools available to address NDLS (Section 2).
2. achieving the operational effectiveness of plans to address NDLS (Section 3).
3. reviewing, exercising, and testing plans for addressing NDLS (Section 4).
4. providing effective governance of, and transparency, regarding plans for addressing NDLS both in advance of and during an NDL event, and engaging with participants (eg clearing members and clients) and authorities (Section 5).

The paper presents a number of questions and invites comments on the benefits and challenges of various approaches, as well as potential ways to overcome challenges.

Inputs to the paper

In developing this paper, the Committees considered input from:

1. A stocktake of current CCP practices in place in the area of plans for addressing NDLS based on responses to a questionnaire distributed to CCPs.
2. A CCP workshop session conducted in July 2021.
3. The Committees' working knowledge of practices currently used by CCPs.

The Committees would like to express appreciation to the industry participants in this process who attended the information session and/or responded to the Committees' CCP NDL planning questionnaire.

Further work

The Committees are seeking comments on the different elements covered in this discussion paper from a broad range of interested stakeholders – including CCPs, clearing members, clients of clearing members, buy-side, market participants, academics and the general public.

In particular, the Committees request views on four overarching questions:

1. Are there areas in the context of CCP NDIs where further guidance under the CPMI-IOSCO *Principles for financial market infrastructures* (PFMI)¹ might be helpful? If so, what are the potential areas where further guidance might be most helpful?
2. Are there any additional points of consideration or practices that would help CCPs effectively and comprehensively address losses from non-default events that are not mentioned in this discussion paper or in the PFMI and existing guidance or that require additional clarity from authorities? If so, what are they?
3. Are there particular challenges that CCPs face in planning for an orderly wind-down in a NDI scenario? What are some potential ways to motivate further progress in orderly wind-down planning?
4. Would a similar study in the context of NDIs for FMIs other than CCPs be helpful? Would further guidance under the PFMI be helpful in this context?

In addition, the Committees request views on the specific questions detailed in the discussion paper. Please support your comments with detailed arguments and evidence, where applicable. Responses are requested by 4 October 2022.

Content of the discussion paper

1. Identifying scenarios that could lead to NDIs, quantifying potential NDIs, and assessing the sufficiency of resources and tools

Section 2 discusses the underlying analysis conducted by CCPs to develop their plans to address NDIs. The starting point of the analysis is identifying NDI scenarios in a manner consistent with PFMI Principle 3, Key Considerations 1 and 4, including those that might lead to recovery. This is in line with CPMI-IOSCO's *Recovery of financial market infrastructures - Revised report* ("Recovery Guidance")², which notes that an FMI should identify scenarios that may prevent it from being able to provide its critical services as a going concern.³ Further analysis includes quantifying the potential loss exposures under the identified scenarios, identifying the tools and quantifying the resources available to address those losses, comparing the available tools and resources to the potential loss exposures, considering the timing of any liquidity needs to help identify any potential resource shortfalls, and developing plans to address any shortfalls. Finally,

¹ Committee on Payment and Settlement Systems and International Organization of Securities Commissions, *Principles for financial market infrastructures*, April 2012.

² Committee on Payment and Settlement Systems and International Organization of Securities Commissions, *Recovery of financial market infrastructures – Revised report*, July 2017.

³ See Recovery Guidance, paragraph 2.4.5. This analysis is also informed by related work by the Financial Stability Board. See section 1.2 of Financial Stability Board, *Guidance on Financial Resources to Support CCP Resolution and on the Treatment of CCP Equity in Resolution*, November 2020. ("FSB Guidance on Financial Resources in Resolution").

the section discusses a range of practices in planning for orderly wind down as a result of NDIs in case the recovery plan proves, in particular circumstances, to be ineffective.

2. Achieving the operational effectiveness of plans to address NDIs

Section 3 addresses practices to promote operational effectiveness of a CCP's plans to address NDIs, ie taking steps to assess, and to increase, the likelihood that the intended results of the CCP's approach are obtained. This discussion includes enforceability of the CCP's intended tools and reliability of performance by relevant stakeholders and third parties. These aspects are both especially important given the historical lack of experience with incidence of NDIs that have been sufficiently severe as to require the use of recovery tools. The section also discusses using the resources and tools appropriately within any applicable regulatory or contractual constraints. Finally, the section addresses the availability of information technology systems and processes to support CCPs' efforts to address NDIs should they arise.

3. Reviewing, exercising, and testing plans for NDIs

Section 4 considers reviewing and testing of plans to address NDIs. This includes internal reviews of plans to address NDIs, the use of crisis management exercises to test plans (both at a CCP-specific level and participation in industry-led multiple-CCP exercises) and the inclusion of internal governance structures and participants (and other relevant third parties) in such exercises. It also addresses using the results of such reviews and exercises to improve the plans to address NDIs and to inform the design and conduct of future exercises.

4. Providing effective governance of, and transparency regarding, plans for NDIs and engagement with participants and authorities

Section 5 discusses effective governance, transparency, and engagement with participants and authorities. Here, the discussion on governance addresses review by senior management, and ultimately the board, of the methodology, practices, and assumptions for managing potential NDIs and responsibility for taking decisions regarding the use of tools for addressing specific NDI scenarios. The discussion on transparency addresses various practices to promote adequate disclosure to relevant stakeholders of the CCP's methodologies for identifying potential NDI scenarios and quantifying potential NDIs, including any relevant assumptions, and the CCP's plans to address the NDIs, including the available resources and tools to address the NDIs. Disclosure to relevant stakeholders concerning tools that have a direct impact on market participants is particularly important to ensure that market participants are prepared to manage these impacts.

Section 6 of the report sets forth a series of indicative questions for comment. Comments on the report (supported with detailed arguments and evidence, if available) should be sent by 4 October 2022 via email to the CPMI Secretariat (cpmi@bis.org) and the IOSCO Secretariat (consultation-05-2022@iosco.org). Comments are welcome on any aspect of the report and need not be restricted to the indicative questions that are highlighted in the discussion paper.

All comments may be published on the websites of the Bank for International Settlements and IOSCO unless a respondent specifically requests confidential treatment.