

## Cover note to the CPMI-IOSCO “Report on central counterparty practices to address non-default losses”

In August 2022, CPMI and IOSCO published a discussion paper “*Report on central counterparty practices to address non-default losses*” (the 2022 Discussion Paper).<sup>1</sup> This report was designed to share existing practices to advance industry efforts and foster dialogue on central counterparties’ (CCPs) management of potential losses arising from non-default events (ie, non-default losses (NDLs)). The 2022 Discussion Paper was motivated by the fact that there is limited common understanding of CCPs’ current practices to address NDLs, including estimating the potential magnitude of NDLs and ensuring adequate resources and appropriate tools to address NDLs.

Consistent with the intent of the 2022 Discussion Paper, CPMI and IOSCO are publishing an updated document entitled “*Report on current central counterparty practices to address non-default losses*”. The purpose of this report is to provide a more complete description of current practices that CCPs employ to address NDLs, and to update the 2022 Discussion Paper with additional practices provided through public consultation.

The process of researching and drafting the 2022 Discussion Paper and the subsequent public consultation process revealed a wide range of practices related to NDLs. Certain practices appear to be well developed, although not all of them are equally widespread. A few other practices appear less well developed, including some that are potentially inconsistent with the *Principles for Financial Market Infrastructures* (PFMI).

The consultation report sought feedback on areas where further guidance might be helpful. The consultation responses indicated a range of views on whether further guidance would be appropriate. Some respondents (CCPs) were opposed to any further type of guidance, noting that guidance could have the effect of limiting CCPs’ flexibility and ability to manage NDL events, given the unique risk profiles of each CCP. Instead, a subset of these respondents suggested encouraging more structured dialogue and information sharing among CCPs, their participants, and other stakeholders.

On the other hand, other respondents (clearing participants) stressed the need for further guidance or additional standards based on the wide range of practices reported in the 2022 Discussion Paper, the potential inconsistencies with the PFMI, and other observations that call into question the adequacy of financial resources to address certain NDL scenarios.<sup>2</sup> Some issues proposed by respondents for guidance or additional standards include:

- guidance on the recovery scenarios analyzed and the approach to quantify potential losses, including the severity and types of scenarios considered;

<sup>1</sup> Report available at:

CPMI: <https://www.bis.org/cpmi/publ/d208.htm>

IOSCO: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD709.pdf>

<sup>2</sup> The findings of the 2022 joint FSB-CPMI-IOSCO report analysing financial resources for CCP recovery and resolution, which found that certain hypothetical non-default loss scenarios could likely exhaust recovery resources and trigger resolution.

- enhanced transparency (both quantitative and qualitative) to participants and other stakeholders on the governance processes to plan for and address NDLS, the potential size of NDLS, the allocation of losses among CCPs and clearing participants, and the calibration of CCP resources to address NDLS; and
- guidance for periodic crisis management exercises across CCPs, participants and other stakeholders.

In light of the range of current practices reported by CCPs and some divergent views reported by the industry through the consultation, CPMI and IOSCO believe that there may be room for further guidance or recommendations under the PFMI, in order to help CCPs and other FMIs fully implement the PFMI and improve overall resilience. Accordingly, CPMI and IOSCO will consider particular areas where further guidance or recommendation may be useful and the content of any such guidance to clarify expectations on practices to address NDLS and general business risk.

In order to inform its analysis, CPMI and IOSCO will conduct a Level 3 (L3) implementation monitoring assessment to evaluate how the general business risk principle (*Principle 15*) and associated principles of the PFMI have been implemented across FMI types.<sup>3</sup> This L3 assessment will look at whether there are implementation issues and highlight any inconsistencies related to Principle 15, some of which are potentially identified in this Report. CPMI and IOSCO will also further analyze the consultation responses and other inputs (including further engagement with industry stakeholders) in considering and developing further guidance or recommendations where appropriate.

CPMI and IOSCO appreciate the thoughtful industry input provided during the consultation process and encourage continued industry efforts to further the development of NDL practices for CCPs and other types of FMIs. CPMI and IOSCO intend to undertake additional work on NDLS across all FMI types, including an assessment of the implementation of Principle 15 and related principles and further engagement with industry stakeholders in order to consider, draft, and publish a consultative document on further guidance or recommendations with respect to NDLS in the near term.

<sup>3</sup> An L3 is a peer review to examine consistency in the outcomes of implementation of the Principles by FMIs. The assessment would cover all types of FMIs apart from central bank FMIs. This is broader than the 2022 Discussion Paper's focus on CCPs but would help provide further input to the question posed in the paper as to whether a similar study or further guidance in the context of NDLS for FMIs other than CCPs would be helpful.