Discussion of « The Demand for Central Clearing: To Clear or Not to Clear? »
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Views are my own and shall not be interpreted as reflecting those of Bank of France or the Eurosystem
The paper in a nutshell

• Empirical paper on decision to clear
  – IT CDS trades (2/3) > FR CDS trades (22%) > DE CDS trades
  – 50% of contracts are cleared, 10% non-eligible, 40% uncleared
  – CDS markets is highly concentrated among a small # of dealers (15, 80%) but they have low net exposure
  – Clearing is mostly used by clearing members (CCP ressembles early CB: they benefit a small # of agents)

• Main results:
  – **Clearing decision** is (reassuringly and as expected by regulators) higher for riskier CDS entity, less liquid contracts, higher counterparty risk
  – **Policy-implication:** Clearing should limit contagation provided CCP default is not more likely

• My discussion
  – Robustness
  – Implication for CCP default proba & recovery and resolution (R&R) procedure
Empirical exercises

• Estimate a probit model (=1 if contract cleared/ 0 else) on three hypothesis:
  
  – **Hypothesis 1:** Clearing is larger if the CDS contract is less liquid and the reference entity is relatively risky
    
    * Likely non-linear and more likely when entity is risky* enough (level & marginal changes of CDS spread, for larger trades (counterparty risk higher), and higher margins reduced clearance)
  
  – **Hypothesis 2:** Clearing is larger if the transaction reduces the amount of collateral to be posted because it reduces the exposure to the CCP
    
    * Cost of clearing matters: trade-off btw limiting contagion & cost*
  
  – **Hypothesis 3:** Clearing is larger when the counterparty risk is larger
    
    * Truer for net sellers of CDS to CCP & riskier entities: consistent w/ CCPs charging add-on margins on riskier counterparties*
How robust are the correlations?

• You show that decision to clear is endogenous to
  – liquidity risk, credit risk, concentration of trades
  – Margin calls, price of collateral

• And maybe non-linear:
  – changes in CDS spread reduce proba of clearing for France and Germany (bc/ of margins) but increases for Italy

• Can you implement « more robust » exercises using « natural experiment » like Brexit exploiting
  – Brexit is likely unexpected and exogenous (to finance) and not impacting default of continental European sovereigns
  – But it has a sizable impact on prices of collateral used to pay margins and on the liquidity situation of market participants,
    • you can exploit both changes in prices & liquidity situation of dealers depending on exposure to shock to see how clearing decision is impacted
Implications of CCPs clearing the riskier trades of the market

• Clearing increases with reduced liquidity, higher credit risk, and if trades are more concentrated among CMs

⇒ CCP-cleared trades will be more and more skewed towards the riskier ones when risk will rise or prices swing downward, leaving the CCP more and more exposed to default risk

• Implications for ex-ante risk management: When contracts are mandatory cleared, the risk exposure of CCP is less skewed towards riskier trades, reducing the average CCP risk exposure
  – Should mandatory clearing be conditional on level of risk?

• Implications for the management of derivatives exposures of non-mandatory-cleared trades: Underlying default probability of CCP likely increases w/ risks
  – Reasonable to condition mandatory clearing on volume cleared
On CCP default and R&R procedures

• Consequence on likelihood of CCP default: Clearing likely increase on risky markets, effect likely non-linear (IT vs DE), and this at the same time
  – increase CCP revenues AND its proba of default
  ⇒ may trigger difference in CCP risk management btw normal and stressed times (amplified by risk-shifting by CCPs, Bignon & Vuilleme, 2018)
  ⇒ Careful scrutiny of detailed CCP exposure in stresser times & allowing for early intervention

• Each R&R tools will not have the same effect
  – Partial tear-up may be especially helpful on non-mandatory-cleared market segments, as suggested in Biais, Heider and Hoerova (2018) to align incentives of CCPs w/ members
Take aways

- Very nice paper contributing with numbers to a (disputed) reform aimed at improving financial stability

- Data are great, result is reassuring
  - the riskier a contract, the more likely participants will “purchase an insurance against default
  - Exploit Brexit as a natural experiment

- Fascinating (potential) policy implications
  - In terms of regulation of margining policy
  - In terms of when mandatory clearing must applied
  - In terms of design of R&R procedure