Discussion of “Central Counterparty Resolution: The Right Move at The Right Time” by Huang, Faruqui, and Shirakami

Economics of Payments IX
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The views expressed are solely those of the authors
CCPs may have to be resolved

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But when should authority intervene?

Early?

→ Spend public money when CCP could have recovered

Late?

→ Costly if the CCP does not recover
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How to make CCP member contribute?

Cash calls vs variation margin gains haircut (VMGH)
Increasing importance of CCPs

Turnover in secured euro money market

Share of transactions (%)


Bilateral repo (no CCP)  Bilateral repo (CCP)
Advantages of CCPs

Netting


Information (fewer contractual externalities)

Pooling of risk (mutualisation)

Margin calls

Reduces risk-taking incentives of CCP members (Biais, Heider & Hoerova, 2016)

But could lead to (inefficient?) fire-sales (Biais, Heider & Hoerova, 2018)
European CCP resilient

Mancini, Ranaldo & Wrampelmeyer (2016)
CCPs may have to be resolved

European CCP resilient

Mancini, Ranaldo & Wrampelmeyer (2016)

But repo prices in 2011/12 reflect risk of CCP default

Boissel, Derrien, Örs & Thesmar (2017)
CCPs may have to be resolved

European CCP resilient

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But repo prices in 2011/12 reflect risk of CCP default

Boissel, Derrien, Örs & Thesmar (2017)

What if a CCP does fail?

Bignon & Vuilleumey (2018) study failure of CLAM (Caisse de Liquidation des Affaires en Marchandises) in 1974

Agency problems matter!
Regulators’ objective function (before resolution at time $T$)

$$\int_0^T R_t - X_t - C_t \, dt$$
Regulators’ objective function (before resolution at time T)

\[ \int_0^T R_t - X_t - C_t \, dt \]

Losses on positions
Brownian motion
(Market risk)
Regulators’ objective function (before resolution at time $T$)

$$\int_0^T R_t - X_t - C_t \, dt$$

Contributions from (surviving)

- Cash calls
- VMGH
Regulators’ objective function (before resolution at time T)

\[ \int_0^T (R_t - X_t - C_t) \, dt \]

Losses because members cannot pay contribution

Poisson jump process

\[ dC_t = \xi R_t \, dN \]

(Liquidity risk)
Regulators’ objective function (before resolution at time T)

\[ \int_0^T R_t - X_t - C_t \, dt \]

VMGH: \( R_t \, dt = X_t \, dt \)
Regulators’ objective function (before resolution at time $T$)

$$
\int_0^T (R_t - X_t - C_t) \, dt
$$

Cash call $\Rightarrow \tilde{R}_t$

Poisson jump process

$$
d\tilde{R}_t = -\lambda \tilde{R}_t \, dN_t
$$
Questions/Suggestions

Why is intervention irreversible?

Can authority really afford to wait?

What if the CCP has to declare “bankruptcy”?

What is different for CCPs relative to systemic banks?

How to make stakeholders contribute?

Difference cash call vs. VMGH