Committee on Payment and Settlement Systems

Technical Committee of the International Organization of Securities Commissions

Principles for financial market infrastructures, Consultative report, March 2011

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Principle 7 (Liquidity Risk)

It is not entirely clear why is the Liquidity risk handled completely separately from the credit risk, which is a dominant source of potential liquidity risk (if not the only one.) The lack of liquidity is caused primarily by failure of the participant. In this sense it would be appropriate to put together the credit risk and liquidity risk. Another option would be to include liquidity impacts into the credit risk.

The document does not deal with market liquidity risk; it means the risk of illiquidity of the underlying instruments. We assume that the FMI (namely SSS and CCP) in carrying out their activities do not open positions on their own account (a position is held only by their participants), but in case of failure of one of the counterparties, the SSS and CCP may temporarily hold an open position. If the underlying instrument is not liquid, it can be difficult to close this position.

Principle 6 (Margin)

We are aware of the fact that this principle does not deal with the issue of margins for illiquid and asymmetric instruments. In the case of illiquid instruments, for which it may be difficult to close a position, should be a longer holding time of instrument by CCP properly reflected in the margin. Another problem could cause instruments with asymmetric flows, where the payments by one counterparty may be substantially larger than by the other one. A typical representative is CDS. In case of default of the reference asset is the seller's payment much higher than the premium received. In case of default also significantly increases the risk of default of the seller (a downgrade of credit rating will increase margins, which can lead to failure of the seller). In such a situation it may be problematic to close an open position by CCP. The CCP will be forced to fulfill in full extent, which may expose the CCP to great credit risk. The problem can be further multiplied by the fact that there should not be a standard accepted procedure for determining the correct initial margin.