Christian Noyer: Financial Stability Review “OTC derivatives: new rules, new actors, new risks”

Speech by Mr Christian Noyer, Governor of the Bank of France and Chairman of the Board of Directors of the Bank for International Settlements, at the launch of the latest issue of Bank of France’s Financial Stability Review on “OTC derivatives: new rules, new actors, new risks”, New York, 22 April 2013.

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I am very happy to be with you today to launch the latest issue of Banque de France's Financial Stability Review on “OTC derivatives, new rules, new actors, new risks”.

As you know, every year since 2002, our Review has brought together contributions from prominent academics, practitioners and policy-makers from all over the world on a topical issue.

I warmly thank all the contributors who have enabled us to produce a Review, of great interest, thanks to their papers of exceptional quality and density. I cannot mention all of them and only some authors are with me today; [but you can find all articles in the online and paper versions of the Review, copies of which are available on tables at the back]. Those contributions are very diverse, or even divergent, in their analysis and proposals. That’s how we want it. It is clear we don’t necessarily share the views expressed in the articles but we all believe in the exchange of ideas.

For introducing this FSR, we are extremely fortunate to gather an exceptional panel:

- An outstanding US lawmaker: Senator Dodd, thank you, it’s a privilege to welcome you today;
- A prominent regulator: Paul Tucker, Deputy Governor of the Bank of England, in charge of Financial Stability. Paul, you also chair the Basel Committee on Payment and Settlement Systems and co-chair the CPSS/IOSCO Steering Group on central counterparties: your views on the subject are particularly sharp;
- Two top market practitioners: Michael Bodson, President and CEO of DTCC and Craig Overlander, CEO of Société Générale Americas. You will provide us with the “insider” vision.
- A distinguished academic, who specialized notably on counterparty risk and OTC derivatives: Manmohan Singh, from the IMFThank you all for being with us today.

As you know, for our FSR issues, we always try to pick up topics which are both analytically complex and relevant to current policymaking. This is clearly the case with this issue: the crisis has led the G20 leaders to commit to changing the rules for over-the-counter derivatives markets, with a view to strengthening their security and transparency.

First, strengthening security: all sufficiently standardized derivatives should be subject to mandatory clearing through a central counterparty in order to reduce counterparty risk and foster market liquidity. Second, on transparency, the aim is a registration of all transactions with trade repositories to provide authorities with a consolidated overview of derivatives trading.

The contributions to the FSR show that most commitments have been materialized in a regulatory framework that is currently being finalized: in particular, at the international level, in April 2012 the CPSS (Committee on Payment and Settlement Systems) and the IOSCO (International Organization of Securities Commissions) published the “Principles for Financial Market Infrastructures” that update, strengthen and broaden the former standards applicable in the different jurisdictions.

I will pay a particular tribute to the leadership of the US lawmakers in this field of regulation and the personal action and involvement of Senator Dodd, with the law named after him and his colleague Senator Frank. European Union legislation with EMIR (European Market Infrastructures Regulation) has also marked a decisive step to address the need for further security and transparency on OTC derivatives markets.

But the contributions to the Financial Stability Review, also show that reforms must be pursued.

Before we get to the discussion, let me briefly give you some personal thoughts on this.

Efforts in the reforms should tend to establish a comprehensive, adequately calibrated and consistent regulatory framework.

1. There is a need for a comprehensive framework.

This means that we have to extend and complete security and transparency.

- First, pay a close attention to the regulation of OTC derivatives that will remain non-cleared.
- Second, pay a close attention to the implementation of PFMIs and different regulations to ensure that CCPs maintain state of the art risk management practices (margining, collateral, default funds) and adequate governance both for the sake of both their own soundness and the resiliency of the markets they serve.
- Third, define appropriate principles for resolution and recovery of Financial market infrastructures, and particularly CCPs which now concentrate a high level of risks.
- Last, bring transparency in the area of secured and unsecured interbank lending, which are the underlying reference for interest rate derivatives. Monetary policy considerations also call further transparency in that regard as it requires detailed knowledge of the organization of money market and the real conditions under which transactions take place.

2. Meanwhile due attention should be paid to an adequate calibration of the framework.

The development of multiple concomitant regulations (capital, liquidity etc…) calls for a perfect coordination. We cannot pile up these different approaches without assessing their impact and the costs incurred for the market and the public. This is a particular concern when considering the collateral requirements that stem from the different regulations.

3. Last but not least, we need to promote a consistent framework.

Consistency has several sides

- Consistency across jurisdictions: it is vital as most players on OTC derivatives are global actors: we need to minimize the incentives for regulatory arbitrage;
- Consistency with respect to the localization of market infrastructures, which should remain coherent with respect to the currencies traded: infrastructures should be under the direct reach of the Central Bank concerned by the systemic risk attached to the clearing of large positions in a given currency;
- Consistency regarding the different types of players/counterparties: in order to prevent the move from regulated spheres to unregulated ones, we need to set up a framework where financial innovation, a key factor for economic growth, continue to develop in regulated spheres, and benefit from appropriate risk regulation.

I will not dwell further on these topical issues, which are about to give rise to a fascinating discussion.

It is my hope that we can collectively contribute to enlighten the policy debate.

Let me now give the floor to our panelists.