## Benoît Cœuré: Towards a macroprudential framework for central counterparties

Introductory remarks by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, at a policy panel discussion on the progress with new macroprudential instruments at the ESRB Conference on Macroprudential Margins and Haircuts, Frankfurt am Main, 6 June 2016.

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Ladies and gentlemen,

I would like to thank the European Systemic Risk Board (ESRB) for organising this event and inviting me to chair this panel. I will make a few brief remarks before handing over to our distinguished group of speakers.

I do not intend to talk about the development of new macroprudential instruments – I will leave this to our panellists. Instead, I will try to set the stage by saying a few words about central counterparties (CCPs), as they are very much in the spotlight when it comes to debates about the future of macroprudential policy.

The strong regulatory push towards central clearing in recent years has clearly helped improve the safety and stability of the financial system. Among the many well-known advantages of central clearing are the reduction in counterparty credit risk, and the simplification of the network of exposures through multilateral netting and risk sharing, which also comes with a more efficient use of collateral. Default risk, no longer being dispersed thinly across the global financial system[1], is better pooled and monitored.

At the same time, the drive towards central clearing has made CCPs key nodes for propagating risk in the system[2]. Given the central role CCPs play in the financial system and the potential effects their risk management can have on the economic cycle, it has become increasingly important to consider CCPs not only from a microprudential but also from a macroprudential perspective. Therefore, the discussion about macroprudential policy, previously almost exclusively referred to in the context of banks, is now being expanded to include CCPs. Indeed, the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) already considered some of these aspects when they published in 2012 the *Principles for financial market infrastructures* (PFMI)[3], for instance by requiring CCPs to adopt stable-through-the-cycle margin practices and collateral haircuts.

Before turning to the more recent work of the CPMI and IOSCO in this area, allow me to recall two important general considerations that should be taken into account when developing macroprudential frameworks for CCPs.

First, we should not try to apply blindly to CCPs the macroprudential tools we have developed for the banking sector. Unlike banks, whose social function is to transform risk and maturity, CCPs are not in the business of taking risk directly but of pooling risk.

1 See Adrian, T., and Shin, H.S., "Liquidity and financial contagion", Financial Stability Review, Banque de France, February 2008.

2 See Cœuré, B., "The known unknowns of central clearing," speech at the meeting on the global economy and financial system hosted by the University of Chicago Booth School of Business Initiative on Global Markets, Coral Gables, 29 March 2014.

3 See Committee on Payments and Settlement Systems and Technical Committee of the International Organization of Securities Commissions, "Principles for financial market infrastructures", April 2012, http://www.bis.org/cpmi/publ/d101a.pdf.

Therefore, we do not want to regulate them primarily as risk takers. Instead, our aim is to control the way they propagate risk, including in particular the way they allocate losses in case of a participant's default. Second, while the microprudential and macroprudential approaches have different perspectives, they may in practice rely on some of the same tools to reach their objectives. A macroprudential approach to CCPs should also involve elements of sound microprudential risk management, as both can be tightly interlinked.

Bearing this in mind, allow me to lay out five elements of the macroprudential approach to CCPs which are being developed and implemented at CPMI-IOSCO level.

*First*, we are currently working towards establishing a set of criteria to identify CCPs that are systemically relevant in more than one jurisdiction. This is an important issue given that the PFMI require CCPs with cross-border relevance or with a more complex risk profile to apply more stringent risk mitigation standards – in particular a "cover 2" requirement for calibrating their stress testing and for sizing their financial resources. Providing authorities with a consistent framework for assessing systemic relevance is the starting point of any macroprudential approach.

*Second*, we want to ensure that the financial buffers built up by CCPs in good times are highly robust, thereby reducing the need to take sudden and abrupt measures in more stressed situations. In this context, we are focusing on making CCPs fully resilient by ensuring they are rigorously applying the PFMI, and have adopted appropriate arrangements for recovery planning in line with the guidance issued by CPMI-IOSCO in 2014. In this regard, CPMI-IOSCO will publish this summer two reports that assess the way international requirements are being implemented, drawing on surveys carried out with a significant number of CCPs worldwide. Additional guidance will be proposed in some areas, such as on stress testing. In other areas, such as recovery planning, we will ensure the existing guidance is properly and fully implemented.[4]

This work is fully consistent with the forthcoming guidance by the Financial Stability Board (FSB) on CCP resolution.

The *third* area where the forthcoming reports will propose further guidance is in the identification and mitigation of potential procyclical behaviour. Building on the requirements for margining and haircut-setting practices in the PFMI, we will now go further by requiring CCPs to take a holistic approach to addressing the issue within their risk management frameworks. The guidance will also point out that a CCP is expected to measure procyclicality by using quantitative metrics, and to include considerations related to procyclicality in its model validation process. One open question is whether we should raise the bar even further by establishing minimum, binding margin floors, as is now the case for non-centrally cleared securities financing transactions.[5] I trust our panellists will share their insights on this issue.

As a *fourth* step, I believe it would be helpful to enhance our capacity to identify and address financial vulnerabilities in CCPs at an early stage by complementing CCP in-house stress testing with a framework for supervisory CCP stress testing that can be conducted across jurisdictions. Supervisory stress testing can be a key building block of the macroprudential framework for CCPs if it accounts for the propagation of risk across CCPs as well as the spillover to, and spillback from, their clearing members. The recent European Union-wide stress test led by the European Securities and Markets Authority (ESMA) is a promising first

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4 See also Cœuré, B., interview with Risk Magazine, 19 May 2016.

5 See Financial Stability Board, "Strengthening Oversight and Regulation of Shadow Banking -Regulatory framework for haircuts on non-centrally cleared securities financing transactions", 14 October 2014.

step in this direction[6]. While this is an ambitious project and will take some time, I hope we can propose a way forward at the G20 summit in September.

Finally, we will need to make substantial progress in understanding and assessing interdependencies between CCPs and their participants, across the multiple relationships they have with each other. Mapping the complex network of these interlinked exposures is crucial from a macroprudential standpoint. This work is currently being carried out by the FSB, and its success will depend on the full and timely availability of data from all jurisdictions involved in the exercise. The information- sharing framework and the methodology being developed for this analysis is a precondition for future work, such as supervisory stress testing.

Pooling risk in CCPs brings benefits for market participants and generates positive externalities for the broader economy – provided that the propagation of risk is well understood and well regulated. As Mark Twain once said: "Put all your eggs in the one basket and – watch that basket!"[7]. The macroprudential framework for CCPs is about making sure that we're watching that basket.

I will now hand over to our panellists.

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6 See ESMA report, "EU-wide CCP Stress test 2015", 29 April 2016.

7 "Behold, the fool saith, 'Put not all thine eggs in the one basket' – which is but a manner of saying, 'Scatter your money and your attention'; but the wise man saith, 'Put all your eggs in the one basket and – watch that basket!'", in Twain, M., *The Tragedy of Pudd'nhead Wilson*, chapter 15, 1894.