

François Villeroy de Galhau: Recovery and resolution of CCPs

Opening speech by Mr François Villeroy de Galhau, Governor of the Bank of France, at the Policy conference “Recovery and resolution of CCPs”, Paris, 24 June 2016.

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I will not comment now on the results of the British referendum. Be only assured that we are mobilised and determined.

France has already quite a long history with CCPs. La Caisse de liquidation, based in Le Havre, was the first to provide, in 1882, an insurance against counterparty risk on commodities markets. This history explains why we have a longstanding role as CCP overseer; it gives us also a special interest and commitment to contribute to this policy issue, on which I would like to share a few thoughts. ***Considering the growing importance for financial markets and financial stability of CCPs, it is our collective responsibility - shared among the financial industry and regulators- to maintain a robust network of CCPs. As we strongly believe in the key role of CCPs we must ensure that they never become the next “too big to fail” institutions.***

The growing importance of CCPs is linked to regulatory changes, but not only. It is also linked to financial disintermediation and changes in the behaviour of market participants, which in both cases are most welcome evolutions.

Regulatory changes and the Pittsburgh agenda have been obviously major factors contributing to the systemic importance of CCPs. However, the clearing obligation for OTC derivatives is not the end of the story.

Another potent factor is indeed the movement towards ***disintermediation***, which should further amplify the role of CCPs. This disintermediation trend is fostered by *public initiatives*, such as the Capital Markets Union promoted by the European Commission in the EU. This movement is also related to *market initiatives*, notably in our financial centre here in Paris, to promote market financing as a complement for bank credit: for instance, the ESNI (Euro Secured Note Issuer) allows for the securitisation of high quality credit claims to improve SME financing.

We also see a ***growing appetite of market participants for central clearing*** to further secure their transactions. Repos are increasingly cleared in CCPs in the EU, and this has stood as a key factor in the resilience of the European repo market over the latest years.

However, ***with greater systemic importance come greater responsibilities.***

Greater responsibilities lie first with the industry.

The clearing industry must have a coherent and resilient organization. We must not yield to the temptation to maximize netting effects.

We all agree that the primary objective of central clearing is to reduce systemic risk. CCPS cannot be considered primarily as vehicles for improving operational and capital efficiency. They should be as well financial stability enhancers. The proposed merger of the London Stock Exchange Group and Deutsche Börse might be a relevant illustration of the risk of a trade-off between these two objectives. So we will closely look at it from a financial stability perspective, as I already said.

It is also industry’s responsibility to locate CCPs in the appropriate currency area, to enhance the management of liquidity risk, which is essential for CCPs’ resilience.

Clearing members are also responsible for steering CCP risk management towards best practices. Their participation in the governance of CCPs is key in this regard. This should be

materialised by regular feedback on CCPs' methodology and stress test results, which should be disclosed to participants.

When considering regulators and overseers, the priority must be to constantly improve CCP resilience, building on the CPMI-IOSCO Principles for Financial Market Infrastructures. We must avoid regulatory arbitrage and competition through the reduction of prudential requirements. This means **tighter international harmonization** of CCP requirements. In this regard, I salute the important work currently carried out by CPMI-IOSCO to promote more granular guidance and steer CCPs towards best practices. This includes the **alignment of incentives** among market stakeholders to improve risk management. This can be illustrated with the promotion of the "skin in the game" for CCPs in the default waterfall, which aligns the incentives of CCP shareholders with those of clearing members. This should also include the conduct of **frequent supervisory stress tests** for CCPs, to bring more comfort with regard to their resilience. It would create an objective external metric to ensure the adequacy and the consistency of their risk practices. This needs to be developed to assess the management of credit risk but also of liquidity risk, which is too often ignored.

Finally, let me say a last few words to introduce the precise topic of this conference. As you know, regulations require CCPs to consider all extreme but plausible scenarios in their daily risk management. However, **we cannot ignore tail risk**. The remote possibility that CCP resources would be exhausted in a crisis must be dealt with appropriately. This is why we need **robust recovery and resolution arrangements** for CCPs, to preserve financial stability in all circumstances.

Before I leave you to discuss this complex issue, I would like to offer a few thoughts:

- **The cornerstone principle of resolution is always financial stability**: this should be achieved through the continuity of CCP services when possible, but not at the expense of the financial survival of CCP members and clients.
- The permanent cost of such a regime should be assessed carefully in order to **preserve incentives in favor of central clearing**. CCPs already have properly sized financial resources and a sound business model that must be preserved.
- Resolution arrangements should balance **predictability for CCP participants and flexibility for the resolution authorities**, whose task to preserve financial stability in the most extreme circumstances should not be hampered.
- And lastly, **cooperation between authorities and consistency at the international level** are key to ensure efficient resolution planning and resolution actions, and to avoid regulatory loopholes and arbitrage. This conference is indeed illustrative of the spirit for further international cooperation in this field.

Thank you for your attention. I wish you a very fruitful conference.