

Benoît Cœuré: A cooperative approach to CCP recovery and resolution

Panel intervention by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, at the ILF Conference on "Resolution in Europe: the unresolved questions", Frankfurt am Main, 23 April 2018.

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The order of the topics at today's conference on "resolution in Europe" was well planned.¹

The fact that we are discussing central counterparty (CCP) resolution after discussing bank resolution echoes the fact that CCP resolution is, by and large, an event that occurs only when all other safeguards, including bank resolution, have failed.

There are a number of reasons for this.

One is that the ways in which CCPs are set up makes them particularly resilient. CCPs are not banks, they are (financial market) infrastructures.

They manage the risk of a matched book and rely on the strength of their membership to provide margin and to share losses if this proves insufficient. Bail-in is integral to CCPs' operational set-up, as clearing members are required to share losses. In this way, their resilience is further strengthened by banking supervision and recovery and resolution arrangements which help ensure that clearing members meet their obligations.

Another reason for CCPs' resilience is the implementation of international standards.²

The Principles for Financial Markets Infrastructures of the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) have recently benefitted from more granular guidance providing clarity to CCPs and their regulators.³

This also includes risks other than financial ones. The adoption of the CPMI-IOSCO guidance on cyber resilience for financial market infrastructures, for example, is an important step towards operational resilience.⁴

Yet, while CCP resolution remains a very unlikely event, the disorderly failure of a major CCP would be disastrous.

Many CCPs are globally systemic, responsible for clearing global markets and with participants from across the world. This is why the Financial Stability Board (FSB) guidance on central counterparty resolution, and its focus on planning and cooperation between authorities, is important.

Cooperation in resolution planning, and co-ordination between recovery and resolution planning, is essential to ensure that a CCP is always able to continue performing its systemically relevant functions across all concerned jurisdictions. I will return to this in a minute.

I also welcome the fact that policy discussion is now scrutinising seriously the wisdom of increased top-down prefunding requirements for CCP resolution. It is doubtful that such requirements would be effective or proportionate, given the very low probability of CCP resolution and the marked differences between CCPs' risk profiles.

What is more, increasing funding requirements could discourage the use of CCPs and instead push counterparties towards riskier and more opaque bilateral clearing. And while I would not

exclude cases where additional financial resources should be available for both recovery and resolution, ring-fencing resources *for resolution only* may distort the incentives of all stakeholders to support a successful recovery.

That said, the resolution authority should have flexibility to determine the optimal choice of available tools, as well as the best point in time for entry into resolution, as long as the “no creditor worse off” principle is respected.

It is helpful to assess how further guidance could support authorities in assessing potential resolution funding needs for individual CCPs, taking into account, for example, the specific risk characteristics of the products they clear, the types of market they serve and the concentration in CCP memberships. I fully support work currently under way in the FSB in this respect.

Today, I would like to focus on three key areas where more work is needed.

First, more international cooperation is needed.

Authorities responsible for several major cross-border CCPs have not yet embarked on resolution planning and no cross-border crisis management arrangements are yet in place.⁵

This could be because of barriers to sharing confidential information, including different approaches as to what is considered confidential and what timely. If that is true, then these barriers need to be removed.

Likewise, authorities may be reticent to engage with others while legislative frameworks are still evolving. Assessing the cross-border implications of a CCP resolution takes time and discussions should get under way as soon as possible.

CPMI and IOSCO are conducting some work in this respect.

Second, authorities need to better understand how a CCP resolution might look like.

CCP resolution scenarios cannot be defined in absolute, quantitative terms given the nature of market events causing resolution. There will always be considerable uncertainty around CCP resolution and related funding needs.

Nevertheless, further steps should be taken to improve the analytical foundation of CCP resolution planning and to better prepare authorities.

While the FSB is addressing this issue in its report, I see two steps in particular.

First, CPMI and IOSCO have recently published guidance for supervisory stress testing, which includes guidance on how multiple authorities can conduct stress tests.⁶

Testing a CCP’s recovery plan by authorities may help to assess the market conditions under which recovery – and potentially resolution – may be necessary, as well as the potential funding required. Internationally coordinated stress-testing is essential to foster a better understanding of the aggregate amount and quality of committed funding that is available across major CCPs.

Co-ordinating CCP and banking stress testing will provide additional understanding on how resolution plans would work in case of extreme scenarios.

Second, recent analysis of central clearing interdependencies carried out by the standard-setting committees has revealed the limited number of banking groups that are members of CCPs across the world, thereby closely linking CCPs themselves.⁷

Even without stress testing, it is easy to understand that a CCP under stress would send a

liquidity shockwave across its participants and beyond as it requires additional margins and/or passes on losses. This is especially important for central banks. With stress testing, potential funding strains can be further explored, and useful information for CCP and bank supervisors as well as resolution authorities can be gleaned.

Third, European arrangements for CCP recovery and resolution must be coordinated.

The significant interdependencies between CCPs globally are also present in the Single Market. Resolution planning should therefore be coordinated across all European Union CCPs.⁸

This is crucial to preserve financial stability within the Union in the event of a crisis.

Critics of EU-wide coordination claim that the fiscal risks of central clearing arise primarily in CCPs' respective home countries. But given that cross-border membership of EU banks in EU CCPs is widespread, this argument is flawed.

The losses faced by a CCP during default management and recovery and resolution are mostly borne by its clearing members, rather than by the CCP itself. Even though a CCP's home country may choose to provide temporary public funding during resolution, such support would be recouped from clearing members, in line with their obligations to contribute to comprehensive loss absorption.

Therefore, fiscal risks would in fact appear to arise in countries in which major CCP *participants* are located. Domestic authorities may need to provide these participants with financial support if they are faced with large payment obligations due to CCP losses.

Thus, EU-wide coordination in resolution planning is necessary to ensure that system-wide risks are fully identified and mitigated in a fair and effective manner.

At the same time, a resolution is not a discrete event. The boundaries between default management and recovery and resolution are blurred, so it is important to align responsibilities and control measures throughout the potential lifecycle of EU CCPs.

The resolution of a CCP relies, to a large extent, on the recovery process. Under the legislative proposal for a regulation on CCP recovery and resolution, authorities will be required to enforce CCPs' contractual obligations before using any resolution tools, subject to limited exemptions.

Another aspect to keep in mind is that systemic risk for the Single Market may arise not only from EU CCPs, but also from non-EU CCPs with substantial activities in the EU. This aspect will become increasingly important after the United Kingdom's departure from the EU.

Against this background, current efforts to strengthen the EU arrangements for third country CCPs are very important. In particular, if a third country CCP is systemically important for the EU, it is not enough to focus on regulatory equivalence alone.

While deference to home country rules and supervisors should be used to the extent possible, EU authorities also need to have tools for direct liaison with a third country CCP to identify, clarify and address issues that may pose specific concerns from an EU financial stability perspective. This is fully in line with the set up in other major jurisdictions.

Similarly, as regards CCP resolution, the development of home country arrangements in line with international standards must be complemented with the involvement of relevant EU authorities in resolution planning in line with international standards, to ensure that their systemic risk concerns are fully taken into account.

To sum up, CCPs are systemically important across border and across the EU. Any recovery and resolution planning for individual CCPs therefore requires an EU wide systemic risk

assessment and a strong co-ordination at global level.

At EU level, this could involve, for instance, aggregated data collection, joint stress-testing and crisis simulation exercises, and the closer coordination of related supervisory assessments and recovery and resolution planning. And given the financial stability, macroprudential and liquidity issues a CCP resolution raises, central banks must be involved in all aspects of this work.

Thank you.

¹ I would like to thank Corinna Freund for her contributions to this speech. I remain solely responsible for the opinions contained herein.

² At all times, CCPs are required to hold prefunded, high quality collateral to cover 99% of current and potential losses that may arise from their participants defaulting. On top of this, they need to hold additional resources to withstand a range of extreme but plausible stress scenarios. These could include, for instance, the two largest participants in a major cross-border CCP defaulting. To prepare for situations of even more extreme market distress, CCPs also need to formulate recovery plans that show how they intend to absorb losses and restore business viability. See Cœuré, B. (2015), "[Ensuring an adequate loss-absorbing capacity of central counterparties](#)," Remarks at the Federal Reserve Bank of Chicago 2015 Symposium on Central Clearing, Chicago, 10 April.

³ See CPMI-IOSCO (2017), "[Recovery of financial market infrastructures – Revised report](#)", July.

⁴ See CPMI-IOSCO (2016), "[Guidance on cyber resilience for financial market infrastructures](#)", June. The Eurosystem recently established the Euro Cyber Resilience Board (ECRB) for pan-European Financial Infrastructures, which will help raise awareness and provide a platform for discussing issues related to cybersecurity. See Cœuré, B. (2018), "[A Euro Cyber Resilience Board for pan-European Financial Infrastructures](#)", introductory remarks at the first meeting of the ECRB, Frankfurt, 9 March.

⁵ Under the FSB Key Attributes of Effective Resolution Regimes, FSB members have committed to establish crisis management groups for CCPs that are systemically important in more than one jurisdiction.

⁶ See CPMI-IOSCO (2018), "[Framework for supervisory stress testing of central counterparties \(CCPs\)](#)", April.

⁷ See BCBS, CPMI, FSB and IOSCO (2017), "[Analysis of central clearing interdependencies](#)", 5 July.

⁸ See also ECB (2017), Opinion of the European Central Bank on a proposal for a regulation of the European Parliament and of the Council on a framework for the recovery and resolution of central counterparties and amending Regulations (EU) No 1095/2010, (EU) No 648/2012, and (EU) 2015/2365 ([CON/2017/38](#)), 20 September.