

Benoît Cœuré: The case for cooperation - cross-border CCP supervision and the role of central banks

Introductory remarks by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, at a conference on CCP risk management, organised by the Deutsche Bundesbank, the European Central Bank and the Federal Reserve Bank of Chicago, Frankfurt am Main, 27 February 2019.

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It is with great pleasure that I welcome you to Frankfurt. I thank you all for coming, especially those who have travelled from far away.

I am delighted to open this conference, which has been organised jointly with our colleagues from the Deutsche Bundesbank and the Federal Reserve Bank of Chicago. The idea behind today's event is to establish a regular forum to exchange views on pressing issues around central clearing and its challenges in terms of risk management.

Before briefly outlining what we hope to learn from this conference, I would like to say a few words in memory of our colleague and friend, Robert T. Cox, who passed away in December.

Bob was not only a driving presence in all matters surrounding central counterparties (CCPs) – in his words: a CCP is a CCP is a CCP¹ – he was also one of the pioneers behind this event. We will think of him, his family and his colleagues at the Chicago Fed as we discuss issues close to his heart today. This conference is a monument to his memory.

To open what I hope will be a day of thoughtful and lively discussion, I would like to share a few thoughts on today's three topics, in my capacity as both member of the ECB's Executive Board and Chair of the Committee on Payments and Market Infrastructures (CPMI).

Global CCPs require enhanced cooperative oversight across borders

Let me begin with the challenges we face in regulating and overseeing global cross-border clearing activities.

As the clearing landscape evolved after the crisis, some derivatives markets became highly concentrated. Major markets are now cleared through a few global CCPs, which, as a result, have become systemically important for multiple jurisdictions besides the one in which they are headquartered.² If not managed appropriately, risks channelled through these CCPs could spread rapidly across borders with potentially destabilising effects for financial markets more widely.

For example, for many EU CCPs, including the most important clearing hubs, over two-thirds of the derivatives transactions they clear are submitted by financial institutions incorporated outside the CCP's home Member State. Credit risks and potential losses are thus borne mainly by financial institutions in other EU or non-EU countries, and –once bank shareholders and creditors have been bailed in – taxpayers in those countries may ultimately have to foot the remaining bill.

For this reason, market authorities, prudential supervisors and central banks have a keen interest in other countries complying with the highest financial and operational CCP risk management standards. They rely on home authorities to carry out prudent due diligence. Such cooperation with other authorities has been enshrined by the CPMI and the International Organisation of Securities Commissions (IOSCO) as Responsibility E of the Principles for Financial Markets Infrastructures (PFMI).

Given the stakes involved, blind trust is not enough. I would argue that we must strike a balance

between facilitating market integration through cross-border access and safeguarding the ability of authorities to fulfil their statutory tasks and objectives. Finding this equilibrium is, of course, a challenge and I welcome the work carried out by the Financial Stability Board, at the behest of the Japanese G20 presidency, to address potential regulatory causes of market fragmentation.³

As I see it, fragmentation is not always caused by overlapping regulations, but often by a failure to cooperate. Mutually acceptable solutions can and should be found to meet the legitimate expectations of all the authorities involved.

The scope of these solutions may differ depending on the degree of interconnectedness.

At the European level, for example, where financial markets are highly interdependent and integrated, it is clear that the cross-border stability implications are significant and in many ways exceed those of our banking sector. Supervisory coordination at the EU level should reflect this close nexus.

Unfortunately, however, the competence for CCP supervision remains almost exclusively national. In this respect, despite significant legislative efforts, the lack of ambition of the current revision of the European Market Infrastructure Regulation (EMIR) is regrettable.⁴ Given that the brunt of default risk in EU CCPs is borne by their clearing members, most of whom are directly supervised at the European level, the principle of aligning liability and responsibility clearly implies European supervision of EU CCPs. The current text can at best be seen as a modest step in that direction.

At the global level, we should strive for an international framework based on two pillars: proportionality and cooperation.

Proportionality means that where financial stability implications are limited, outcomes-based equivalence and full deference mechanisms, based on compliance with international principles, can allow for cross-border activities that meet minimum standards of safety and soundness.

Where global CCPs are systemically important for financial systems or currency areas, however, each authority should have the right and duty to ensure that imported risk is managed at least as diligently as its own standards would dictate.

This is the core purpose of the revisions to the EU's recognition framework for third-country CCPs. The European Commission and EU legislators have taken a balanced approach to ensure that this can be implemented in a pragmatic, flexible and efficient manner.

The success of this framework, however, relies on enhanced cooperation between authorities. Cooperation fosters trust, thus facilitating deference among supervisors to the extent possible. It also helps the authorities in implementing overlapping expectations based on different mandates in a coherent and mutually satisfactory manner.

Cooperation has, in fact, always been the ECB's preferred approach to the oversight of financial market infrastructures (FMIs). This cooperation should rely on two elements, as agreed at the international level: first, effective cooperative oversight arrangements and, second, crisis management groups to allow for mutual consultation in recovery and resolution planning.

Unfortunately, for several global CCPs, these arrangements do not yet exist, or do not involve all relevant authorities, despite international commitments. These delays are a source of concern, not least as seven years have passed since the adoption of the PFMI⁵, and almost five years since international standards were adopted for both the recovery⁶ and resolution⁷ of FMIs.

I urge all parties involved to accelerate progress in this area.

The Eurosystem needs to be able to conduct effective oversight

Cooperation is also indispensable for the second topic of today's conference, namely CCP liquidity and the role of the central bank of issue. In Europe, cooperation ensures that the ECB and the Eurosystem can conduct effective oversight of euro-denominated clearing activities, wherever they may be established.

In 2017 the ECB recommended an amendment to its Statute to clarify its competence over CCPs for the purpose of carrying out its monetary functions.⁸ The ensuing debate among legislators and policymakers in the EU and beyond was marred by some misunderstandings, however, which I would like to dispel today.

As you all know, some central banks are CCP supervisors. The ECB is not,⁹ and has no intention of becoming one. In our role as central bank of issue for the euro, we focus solely on the interplay between central clearing and our monetary mandate.

Let me clarify this by highlighting three channels through which central clearing interacts with core central bank objectives.

First, CCPs play a key role in the euro money market, which is essential for monetary policy transmission. In the EU, 70% of repos are cleared through a CCP, making repo CCPs critically important to this market. CCPs also act as major repo counterparties when reinvesting the large amounts of collateral they collect. Disruptions affecting, or caused by, a CCP can have ripple effects through the euro repo market, which may affect the conduct of monetary policy. The ECB therefore has a clear and legitimate interest in preventing or mitigating such disruptions.

Second, CCPs are financial market hubs connecting banks as well as other market infrastructures, including payment systems. As a result, large payment flows are settled on a daily basis between CCPs and their participants. Deficiencies in CCP financial risk management can transfer liquidity strains to banks, thereby affecting both their capacity to extend credit to firms and households and their reliance on the provision of central bank liquidity, not least as banks are key participants in large-value payment systems operated by central banks.

Moreover, given the growth of central clearing and the promotion of settlement in central bank money, cleared markets themselves increasingly rely on these payment systems. The smooth functioning of our payment systems, in turn, depends on the safe operation of clearing infrastructure and the mitigation of liquidity risk.

Finally, central banks can act as a liquidity backstop or a lender of last resort. Such action could be needed if a banking default were coupled with severe market stress. In such a scenario, a CCP would certainly hold high-quality collateral, but it may be unable to generate cash in the market in the very short time it has to manage a default.

Given the systemic importance of CCPs and the scale of potential funding needs, it is essential that CCPs have sound liquidity self-insurance so that a liquidity shortage remains an extreme tail risk and the associated moral hazard is mitigated.

In light of these considerations, which apply across all locations, the ECB has a clear interest in ensuring the safety and soundness of euro clearing. To this end, we need to have a clear legal competence that, importantly, should cover both EU and third-country CCPs.

Proposals to differentiate between EU and third-country CCPs would not only leave considerable pockets of euro clearing without appropriate ECB oversight, they would also raise concerns about market distortions or an unlevel playing field. For example, a responsible central bank cannot extend liquidity to any entity without having a minimum level of information and control over it. It would be rather strange if such differentiation were to make it more difficult for us to

provide liquidity to EU than to third-country CCPs.

This does not mean that we would seek to substitute our judgement for that of EU or third-country CCP supervisors: their primary responsibility to guarantee the resilience of CCPs, and more broadly the stability of our financial system, cannot and should not be questioned.

But we need a set of safeguards so that our concerns are appropriately taken into account in the regulation and supervision of CCPs. I see three such safeguards:

- ♦ The first is adequate information on the operation and risk management of CCPs clearing in euro, and the capacity to assess how they would fare in times of market stress, including through stress testing.
- ♦ A second is meaningful involvement in the supervisory process, to ascertain that CCPs' compliance with prudential and operational requirements provides sufficient guarantees from our perspective as a central bank.
- ♦ And third, we should be able to adopt requirements to address critical central bank concerns. For instance, it would be our prerogative to determine when CCPs should hold central bank accounts for deposit and settlement purposes, and to require targeted enhancements to CCP liquidity risk management when necessary in exceptional market environments.

Everyone should be clear that our ability to carry out our mandate and, where appropriate, to provide liquidity to CCPs, relies on enshrining these safeguards in our regulatory framework.

CCP default management can and should be enhanced

Before concluding, let me say a quick word on today's third topic, the complex challenges CCPs face in managing defaults.¹⁰ CPMI-IOSCO is currently working on default management auctions, which is very welcome as this area of CCP risk management could benefit from further convergence towards shared best practices.¹¹

The recent default at Nasdaq Clearing has certainly focused the minds of policymakers on this issue. There is much ground to cover for CCPs to converge towards best practices, from setting the right incentives for auction participants to properly calibrating their financial resources to cover concentrated positions in thin or illiquid markets. I am sure this workstream will yield valuable conclusions for both regulators and the industry.

Conclusion

In sum, today's conference shows that we are continuing to ensure that CCPs steadily become more resilient and sophisticated in their role as systemic risk managers and so can truly manage any situation. At times, this requires imagination to understand the interaction of participant behaviours, complex portfolios and stress scenarios, which is a prerequisite for setting the right incentives. It also requires humility to understand the limitations of this exercise and the need for fall-back plans. Extreme and unexpected events do happen and the very purpose of CCPs is to act as a circuit-breaker during crises.

For CCPs to perform this role as adequately as possible, all relevant authorities, including central banks, need to pull on the same rope. Europe, with its deep financial interconnectedness and high risk of spillovers, requires a particularly close level of information-sharing and cooperative oversight – the prerequisite for the Eurosystem to provide liquidity to CCPs. The role of the central bank of issue thus needs to be acknowledged appropriately.

On this note, I hope that I have been able to whet your appetite for a vigorous and fruitful exchange of views during today's conference and leave you in the capable hands of the

organisers.

Thank you.

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- ¹ See Cox, R. T. and Steigerwald, R. S. (2017), "[ACCP is a CCP is a CCP](#)", Federal Reserve Bank of Chicago, Policy Discussion Paper, Vol. PDP, No 2017–01.
 - ² See BSCB-CPMI-FSB-IOSCO: Analysis of central clearing interdependencies, [9 August 2018](#) (second analysis) and [5 July 2017](#) (first analysis).
 - ³ See [FSB work programme for 2019](#), 12 February 2019.
 - ⁴ The revision of EMIR as regards the regulatory framework for CCPs was proposed by the European Commission ([Commission proposes more robust supervision of central counterparties \(CCPs\)](#), 13 June 2017). Significant amendments have been made to the text during the legislative process, including the introduction of different frameworks for the supervision of EU and non-EU CCPs.
 - ⁵ Committee of Payment and Settlement Systems (CPSS) and Technical Committee of the International Organization of Securities Commissions (IOSCO): [Principles for financial market infrastructures](#), April 2012. [CPSS was renamed as CPMI](#) as of 1 September 2014.
 - ⁶ CPMI and the Board of IOSCO: [Recovery of financial market infrastructures](#), October 2014 (revised July 2017).
 - ⁷ FSB: [Guidance on central counterparty resolution and resolution planning](#), 5 July 2017.
 - ⁸ [ECB recommends amending Article 22 of its Statute](#), 23 June 2017.
 - ⁹ Article 1 of Council Regulation (EU) No 1024/2013 of 15 October 2013 (the SSM Regulation) explicitly states that it would "not confer on the ECB any other supervisory tasks, such as tasks relating to the prudential supervision of central counterparties".
 - ¹⁰ See also Coëré, B. (2018), "A cooperative approach to CCP recovery and resolution", panel intervention by at the ILF Conference on "Resolution in Europe: the unresolved questions", Frankfurt am Main, 23 April.
 - ¹¹ On 5 July 2017, CPMI-IOSCO announced follow-up work in the area of good practices for CCPs' default management auctions ([Cover Note](#) to the CPMI-IOSCO revised report on Recovery of financial market infrastructures).