

Burkhard Balz: Optimisation in the clearing system – pass me the toolbox

Lecture by Mr Burkhard Balz, Member of the Executive Board of the Deutsche Bundesbank, at the World Federation of Exchanges (WFE), Madrid, 20 March 2024.

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1 Introduction

Ladies and gentlemen,

Distinguished guests,

Before I start, please allow me to express my gratitude to the WFE for the invitation to speak at this event. It is truly an honour to be here today.

The day was long, filled with a wealth of interesting insights, contributions and discussions. I am now the only one standing between you and your well-earned evening and dinner. So, I will try to offer some food-for-thought, as a sort of brief appetiser.

Ladies and gentlemen, as many of you know, the Financial Stability Board recently ran a consultation on a draft report regarding "CCP financial resources in resolution".¹ It introduces a so-called "toolbox". When you hear the word "toolbox", you might imagine a craftsman with a heavy box full of different tools. For me, a scene from the film "Gran Torino", directed by Clint Eastwood, comes to mind.

A young man from the local neighbourhood is tasked with repairing damages to local homes to make up for past wrongdoing. However, he lacks both experience and suitable tools for the job. A grumpy neighbour, brilliantly portrayed by Clint Eastwood himself and with many years of expertise in repairs, hands him out three basic, but helpful, tools² and advises him to acquire more and more tools over time.

This scene reminds me of the beginning of our journey after the financial crisis in 2008. We, too, had repairs to make. Our strategy was, as outlined at the G20 Pittsburgh Summit in 2009, to go for a centralised clearing space in order to make our financial system safer and more resilient.

As we gather here at this WFE Clearing and Derivatives Conference, let us reflect on that scene from the film. We see the symbolic beginnings of an early toolbox containing simple tools, yet brimming with potential and the promise of growth, similar to the journey we have been on over the past 15 years. Now, I wouldn't exactly say that our financial toolbox started out quite as basic as that, but it has certainly evolved enormously over the past decade, with numerous enhancements.

It started on the regulators' side with the Principles for Financial Market Infrastructures

and the FMI Annex of the FSB Key Attributes, which provided the basis for an effective, safe, and sound regulatory landscape for financial market infrastructures. The CCP workplan, initiated by the FSB and CPMI-IOSCO in 2015, set the stage for structured regulation to promote CCP resilience, recovery planning and resolvability. CPMI-IOSCO's various sets of guidance and reports, such as on resilience, recovery, cyber risk and now on margins,³ stand as testimony to our adaptability and dedication. Building on this, the FSB provided – in 2017 – guidance on CCP resolution planning, followed in 2020 by guidance on the treatment of CCP equity in resolution, introducing the five-step approach for effective resolution supervision. This notable work helps resolution authorities to assess the adequacy of a CCP's financial resources and the potential impact of their application on financial stability.

In many jurisdictions, the remarkable upshot of the dedicated efforts of the Financial Stability Board, Committee on Payments and Market Infrastructures and International Organization of Securities Commissions have been transposed into legislation.

But making the clearing infrastructure more watertight and efficient is also in the interest of all market stakeholders. Consequently, market participants and industry stakeholders have worked and are still working diligently to improve clearing by optimising netting, margin, risk models and information exchange. New avenues are constantly being explored –clearing services for cryptocurrency derivatives or dedicated partnership models, to name just two. Advances in technology, such as cloud computing, distributed ledger technology and artificial intelligence, may also offer new opportunities in terms of efficiency and resilience.

These combined efforts have led to a very well-balanced and safe clearing system. Recent crises such as the COVID-19 pandemic and the energy price crisis in the context of the ongoing war in Ukraine have given us a notable demonstration of how robust our system has become.⁴

3 Current landscape/ Navigating CCP financial resources in resolution

But we cannot let that lull us into thinking it's time to hang up our tool belt. As responsible crafters of the financial infrastructure, we still have work to do.

First, there is no doubt that central counterparties have contributed to making the financial system more resilient. But it also means: that central counterparties have become systemically important financial players. The commonly used term "too big to fail" is synonymous with this importance and, at the same time, serves as a call to all of us to take precautions to avoid the failure of the critical functions performed by these FMIs.

Second, we should be aware that central counterparties are embedded in a very complex and highly interdependent ecosystem of clearing members, clients, markets, financial and technological service providers, to name only a few.

And third, we have observed that there has been a constant progression when it comes to the clearing landscape. Clearing services and risk models keep evolving, learning lessons from the past as well as anticipating potential future periods of volatility in the financial markets as a result of geopolitical tensions and climate-related effects.

And these three aspects are what makes further development and enhancement of regulation so crucial. Which is why I very much welcome the strides taken by the FSB in their efforts to further strengthen trust in the clearing ecosystem. First in 2022, the FSB together with CPMI-IOSCO delved into the complexities of CCP financial resources and conducted a quantitative and qualitative exercise, laying the groundwork for the FSB report that's now been produced.

The heart of the present FSB report is the expansion of our existing toolbox to incorporate new features for resolution purposes. The FSB is offering jurisdictions an additional footing to set up instruments to deal with crisis situations severe enough to trigger resolution. Existing, but also new funding instruments are presented and analysed in this report, such as statutory or contractual variation margin gains haircutting for resolution and equity in a first-loss position.

But we need to remember that access to tools is not an end in itself. They must be fit for purpose. So, whenever we're talking about tools for resolution planning, there's a couple of questions we have to bear in mind:

Can these tools contribute to an effective resolution strategy? And do the advantages of using them outweigh the disadvantages?

In this regard, I applaud the FSB's foresight in choosing to design the toolbox in a flexible way. This allows the jurisdictions discretionary scope to address the individual specifics of the supervised CCPs, the local situation of the financial market and, finally, to select the best and appropriate tools for overcoming a crisis.

4 Global collaborations: a vital imperative

Ladies and gentlemen, the FSB report is focused on resolution, and I think we can all agree that resolution is a state that we need to avoid as far as possible. In this context, I would like to emphasise the importance of taking a holistic view of the clearing ecosystem. Especially now that we are entering the digital age and new technologies such as artificial intelligence, cloud and quantum computing and decentralised finance could open up new opportunities for the clearing system. But they also pose new risks.

The nature of CCPs as key cornerstones of our financial markets in a very tight web of interdependencies points us towards the solution:

Trust and close cooperation between regulators and market participants.

Not only between supervisor and CCP but also among and between affected stakeholders such as clearing participants, clients and associated FMIs;

not only at national but also on an international level;

not only among supervisors for times when it's "business as usual" but also with recovery and resolution supervisors and overseers.

The crisis management groups introduced by the FSB for CCPs that are systemically

important in more than one jurisdiction are an excellent example of exactly the kind of collaboration that I am talking about. In the same vein, but taking things a step further, I would like to highlight the approach that we are applying in the European Union with the supervisory EMIR colleges, now complemented by the recently implemented resolution colleges.

Participants in resolution colleges come from various domestic and foreign authorities, such as the supervisory and resolution authorities of the banks affiliated with the CCP and the supervisory authorities of the exchanges and trading venues for which the CCP provides services. In this forum many different perspectives come together to map the possible consequences of a CCP's default and contribute to the crisis resolution strategy.

The international interconnectedness of CCPs requires this kind of proactive approach, a set-up for sharing information and exchanging views. Fora, such as today's WFE event, help to expand and optimise our understanding and contribute to our collective toolbox.

5 Closing remarks

With the new FSB toolbox, we will enrich our capabilities. Having a decent and comprehensive kit of tools means that we are better prepared to keep the clearing ecosystem in tip-top good shape.

Our commitment to optimising the clearing system is an ongoing journey. We all know there is no "one-size-fits-all" solution. The effectiveness of our toolbox lies in our ability to discern the most appropriate tool for each situation – every challenge may demand a tailored response to navigate the complexities of the financial landscape. Just as a skilled craftsman carefully selects tools for each task, we must approach our financial challenges with equal care.

Let me conclude my speech by going back to our Clint Eastwood film and its closing scenes – please excuse the spoiler: the young man inherits the grumpy man's beloved car, a Ford Gran Torino, but only under the condition that he takes good care of it and does not mess it up with extravagant modifications. We also have the responsibility of taking good care of our clearing system, our "Gran Torino".

With this in mind, let me wish you safe travels through the evolving landscape of financial markets.

Thank you very much for your attention.

¹ [Financial Resources and Tools for Central Counterparty Resolution: Consultation report - Financial Stability Board \(fsb.org\)](#)

² A vice grip, a roll of duct tape, and a lubricant spray (WD-40).

³ [Transparency and responsiveness of initial margin in centrally cleared markets: review and policy proposals \(bis.org\)](#) and [Streamlining variation margin in centrally cleared markets – examples of effective practices \(bis.org\)](#).

⁴ As pointed out for instance in the BCBS-CPMI-IOSCO 2022 report on margin practices //report on margins: [Review of margining practices \(bis.org\)](#) and the 2024 report on "[Transparency and responsiveness of initial margin in centrally cleared markets: review and policy proposals \(bis.org\)](#)"