

CPSS-IOSCO Principles for Financial Market Infrastructures: Introduction and Highlights

Workshop on Principles for Financial Market Infrastructures

South African Reserve Bank

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Agenda

- **Introduction to the *Principles for Financial Market Infrastructures***
 - Motivation for strengthening international standards
 - Key objectives of the CPSS-IOSCO effort
 - How this supports the broader G20/FSB strategy
 - Overview of the principles
- **Highlights of the new principles**
 - Overview of key revisions
 - “Drill down” on financial standards
 - Summary of new standards
- **Follow-on work**

Motivation: Lessons from the crisis

- **Financial market infrastructures (FMIs) were a source of strength**
 - Ability and confidence to settle obligations when due
 - Ability and confidence to continue transacting
- **But room for improvement**
 - More severe stresses are plausible
 - FMI role increasing
 - Mandatory clearing and reporting of OTC derivatives
 - Direct access of FMIs to central bank services
 - Can reduce risk, but only if “moral hazard” is avoided
 - Stronger FMI governance and oversight
 - To reflect growing global roles and interconnectedness

Key objectives of the CPSS-IOSCO effort

- **Harmonize existing standards**
 - Core Principles for systemically important payment systems
 - Recommendations for securities settlement systems
 - Recommendations for central counterparties
- **Strengthen existing standards, based on**
 - Lessons from the crisis
 - Experience/gaps in applying standards
- **Ensure consistent application**
 - CPSS-IOSCO members commit to apply “to the fullest extent possible”
- **Reinforce with “disclosure framework” and “assessment methodology”**
 - Support consistent disclosures by FMIs
 - Support consistent assessments of FMIs by national authorities
 - Support consistent external assessments of FMIs and authorities (eg, FSAPs)

How this supports the G20/FSB strategy

- **FSB identified “four safeguards” to support cross-border use of global CCPs**
 - **Fair and open access** to CCPs
 - Explicit requirements for access to FMIs embedded in the principles
 - Covers access by direct participants, indirect participants, and other FMIs
 - **Cooperative oversight** arrangements between relevant authorities
 - Strengthened “Responsibility E”
 - New pro-active framework for consultation and communication
 - Builds upon proven central bank framework for international cooperation
 - **Resolution and recovery regimes** for CCPs, to ensure continuity even in crisis
 - Explicit requirements for “recovery” and “orderly wind down”
 - CPSS-IOSCO consultation report on FMI recovery and resolution
 - Discusses application of FSB “Key Attributes” to FMIs
 - **Appropriate liquidity arrangements** for each currency a CCP clears
 - New explicit liquidity risk principle

Overview of the principles

<p>General organization</p> <ol style="list-style-type: none"> 1. Legal basis 2. Governance 3. Framework for the comprehensive management of risks 	<p>Credit and liquidity risk management</p> <ol style="list-style-type: none"> 4. Credit risk 5. Collateral 6. Margin 7. Liquidity risk 	<p>Settlement</p> <ol style="list-style-type: none"> 8. Settlement finality 9. Money settlements 10. Physical deliveries
<p>CSDs and exchange-of-value settlement systems</p> <ol style="list-style-type: none"> 11. CSDs 12. Exchange-of-value settlement systems 	<p>Default management</p> <ol style="list-style-type: none"> 13. Participant-default rules and procedures 14. Segregation and portability 	<p>General business and operational risk management</p> <ol style="list-style-type: none"> 15. General business risk 16. Custody and investment risks 17. Operational risk
<p>Access</p> <ol style="list-style-type: none"> 18. Access and participation requirements 19. Tiered participation 20. FMI links 	<p>Efficiency</p> <ol style="list-style-type: none"> 21. Efficiency and effectiveness 22. Communication procedures and standards 	<p>Transparency</p> <ol style="list-style-type: none"> 23. Disclosure of rules, key procedures, and market data 24. Disclosure of market data by TRs

Highlights: overview of key revisions

- **Strengthen existing standards**
 - Governance
 - “Support the stability of the broader financial system, other relevant public interest considerations, and the objectives of relevant stakeholders”
 - Financial resources
 - Separate focus on credit risk, liquidity risk, collateral, and margin
- **Introduce new standards**
 - Segregation and portability
 - General business risk
 - Tiered participation arrangements
 - Disclosure of market data
- **Extend coverage to trade repositories**

“Drill down” on financial standards

- **Previous requirements**
- **Raising the bar**
- **Extending the bar**

Credit risk: previous requirements

- All FMIs: current exposure (CE)
 - Cover largest CE to a single participant
- CCPs: potential future exposure (PFE)
 - Cover largest PFE to a single participant
 - With 99% confidence, via margin
 - In extreme but plausible conditions, via default fund

Credit risk: raising the bar

- Requirements based on “*participant family*,” not *single legal entity*
 - Consolidated exposure to a participant *and all of its affiliates*
- All FMIs: cover CE to *every* participant, not just *single largest*
 - DNS PS or SSS without settlement guarantee: “Cover 2”
- CCPs: PFE coverage
 - Cover every participant family with 99% confidence
 - Minimum additional resources for extreme but plausible conditions
 - “Cover 2” participant families,
 - If CCP has a more-complex risk profile or
 - If CCP is systemically important in multiple jurisdictions
 - “Cover 1” participant family for all other CCPs

Credit risk: extending the bar

- All FMIs
 - Rigorous collateral requirements for “coverage”
 - Rules/procedures to address/allocate uncovered credit losses
 - Including to repay liquidity providers
 - Rules/procedures to replenish used resources
 - To function even in extreme but plausible conditions
 - This supports FMI “recovery” and “resolution”
- CCPs
 - Rigorous stress testing of financial resources
 - Daily stress testing of total available resources
 - “Feed-back” mechanism to augment resources
 - Monthly analysis of scenarios, models, parameters and assumptions
 - Annual full model validation
 - Strong governance over entire process

Liquidity risk: previous requirements

- All FMIs
 - No explicit liquidity resource standard
 - Implied: largest pay-in of a single participant

Liquidity risk: raising the bar

- All FMIs: new, explicit liquidity risk principle:
 - Maintain sufficient liquid resources in all relevant currencies...
 - to settle same-day/intraday/multiday payment obligations...
 - with a high degree of confidence under a wide range of stress scenarios
- Minimum requirement for all FMIs:
 - Cover default of the one participant family...
 - that would generate the largest liquidity obligation for the FMI...
 - in extreme but plausible market conditions
- A CCP should “consider covering 2” participant families,
 - If CCP has a more-complex risk profile or
 - If CCP is systemically important in multiple jurisdictions

Extending the bar: liquidity risk

- Rigorous requirements for stress testing liquidity risks
 - Same as for stress testing PFE
- Rigorous requirements for qualifying liquidity resources
 - Cash and committed lines of credit, swaps, and repos
 - Highly marketable collateral, but only if:
 - Convertible into cash...
 - with prearranged funding arrangements that are...
 - highly reliable even in extreme but plausible market conditions
- Required due diligence on liquidity providers
 - Confirm each LP's capacity to perform as required
 - Confirm each LP has information to manage its risks
- Rules/procedures to address/allocate uncovered liquidity shortfalls
 - To avoid unwinding, revoking, or delaying same-day settlement
- Rules/procedures to replenish used resources
 - To function even in extreme but plausible market conditions
 - This supports FMI “recovery” and “resolution”

Other new principles

- Segregation and portability (for CCPs)
 - Protect customer positions and collateral to the greatest extent possible
 - Allows flexibility to account for different legal regimes
 - Individual or omnibus customer accounts permitted
- General business risk
 - Plans for recapitalization or orderly wind-down, if necessary
 - Liquid net assets funded by equity
 - To ensure continuity of critical services
 - Minimum: six months of current operating expenses
- Tiered participation arrangements
 - Manage material risks to FMI arising from tiered participation arrangements
 - Operational dependencies between direct and indirect participants
 - Credit and liquidity risks between direct and indirect participants
 - Uncertainty about indirect participants' transactions in a default scenario
- Transparency
 - Disclosure of rules, key procedures, and market data
 - Completion of “disclosure framework”
 - Disclosure of timely and accurate market data by trade repositories
 - To meet information needs of authorities, market participants, and the public

Follow-on work

- Assessment methodology and disclosure framework
 - Comments on consultation reports were due June 15
- Recovery and resolution of financial market infrastructures
 - Application of the FSB's *Key Attributes of Effective Resolution Regimes for Financial Institutions* to FMIs
 - Comments on consultation report due September 28
- Authorities' access to data in trade repositories
 - Work underway