
CCP Risk Management: Challenges of Globalisation

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Recent Market Events

Impact of Sub-Prime Losses

- Substantial losses suffered by several large clearing members and/or their affiliates.
- Increased fear of default.
- A break in confidence can be swift and take a firm down quickly (e.g. Bear).

Preventative Measures

- OCC uses several tools to manage the risk presented by financially weakened members.
 - Enhanced surveillance
 - Higher margins
 - Business restrictions
 - Suspension

Lessons Learned

- Information sharing.
- Member surveillance.
- Impact of higher margins / business restrictions.
- Clearinghouse credit lines.
- Liquidation process.
- Flexible approach.

Interoperability and the Code of Conduct

- Code of Conduct signed by all European Union CCPs in November 2006
 - Designed to increase competition in cash markets by (amongst other things) allowing choice of clearing location
 - Any CCP can request to interoperate with any other creating links between multiple CCPs
 - Multiple requests made amongst major market players in France, Germany, Italy, Switzerland and UK.
 - If all are built, would lead to 4/5 CCPs in each of the major European stock exchanges
 - Each CCP must contract with the other on operational and risk management issues

Interoperability: Risk Management Implications

- Committee of Risk Managers from EACH members set up to consider issues
- Seven standards relating to due diligence, operation and ensuring that competition on risk management issues is avoided
- Key Question: How do CCPs collateralise each other?
 - the scenario for a CCP default is multiple large financial institution overnight default AND simultaneous historically extreme market movements
 - What would be the associated exchange/market impact of a CCP defaulting?

'Non-Default' Operational Risks

Transaction Volume Growth

- Capacity management (demand + supply)
- Traffic implications: give-up/give-ins;
- Ongoing integrity & resilience of systems, data and processes

Business Continuity Planning

- Key scenarios: loss of systems; loss of site; loss of personnel
- Testing frameworks, methodologies and limitations
- Industry-wide scenarios and international initiatives

'Non-Default' Operational Risks cont'd

Market Structure

- Multi-platform clearing challenges and opportunities
- Balancing regulatory policy responses to competition with systemic risk implications

Financial

- Margin investment, liquidity and collateral management
- Capital management and allocation challenges