

WFE: CCP Governance Practices

Background

Established in 1961, the World Federation of Exchanges (WFE) is the global industry association for exchanges and clearing houses (CCPs). Headquartered in London, it represents over 250 market infrastructure providers, including standalone CCPs that are not part of exchange groups. Of our members, 34% are in Asia-Pacific, 45% in EMEA, and 21% in the Americas.

WFE’s 90 member CCPs and clearing services collectively ensure that risk takers post some $1.3 trillion (equivalent) of resources to back their positions, in the form of initial margin and default fund requirements. WFE exchanges, together with other exchanges feeding into our database, are home to over 50,000 listed companies, and the market capitalisation of these entities is over $100 trillion; around $140 trillion (EOB) in trading annually passes through WFE members (at end 2022).

The WFE is the definitive source for exchange-traded statistics, and publishes over 350 market data indicators. Its free statistics database stretches back more than 40 years and provides information and insight into developments on global exchanges. The WFE works with standard-setters, policy makers, regulators, and government organisations around the world to support and promote the development of fair, transparent, stable and efficient markets. The WFE shares regulatory authorities’ goals of ensuring the safety and soundness of the global financial system.

With extensive experience of developing and enforcing high standards of conduct, the WFE and its members support an orderly, secure, fair, and transparent environment for investors; for companies that raise capital; and for all who deal with financial risk. We seek outcomes that maximise the common good, consumer confidence, and economic growth, and we engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in a globally integrated financial system.

If you have any further questions, or wish to follow-up on our contribution, the WFE remains at your disposal. Please contact:

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Paper

The turmoil of the 2008 Global Financial Crisis (GFC), illustrated the significant benefits that a CCP provides to financial markets, as a buyer to every seller and seller to every buyer, while requiring that market participants collateralise the risk they take on, and thereby help to reduce systemic risk. During the GFC, CCPs “proved resilient… continuing to clear contracts even when bilateral markets had dried up.”[[1]](#footnote-2) International standard-setters and policymakers, therefore, decided to establish international guidance that would mandate the central clearing of certain standardised derivative contracts [[2]](#footnote-3). Fundamentally, safe and efficient CCPs contribute to reducing credit risk in the marketplace and promoting financial stability. The success of a CCP is inextricable from its role in appropriately managing risk brought to it by market participants.as risk management is a core function of a CCP, and effective risk management practices instil market participant and regulator confidence in a CCP. More recently, the ability of CCPs to effectively manage the risk related to events which have heightened market volatility, such as global conflicts and the COVID-19 pandemic, , has once again demonstrated the resiliency of CCPs and their contribution to financial stability.

While a CCP’s interests are inherently tied to managing risk and promoting financial stability, CCPs also employ additional governance tools to ensure they are able to carry out their risk management role and to address conflicts of interest, including:

* Board and risk committee composition: an optimally composed board brings a broad spectrum of experience and expertise with a reputation for integrity, and ultimately, provide direction and oversight of a CCP’s management;
* Publicly available documentation: such as publicly available Principles of Financial Market Infrastructure (PFMI) qualitative frameworks, rulebooks, and other frameworks which, among other things, outline the management and oversight process at the CCP;
* Legal duties of directors: including fiduciary duties and/or duties of care for the board of directors and risk committee members
* Long-term management incentives: CCP senior manager compensation is often structured to consider the CCP’s performance, including in regard to prudent risk management;[[3]](#footnote-4)
* The establishment of roles/responsibilities between board and management, and the independence of risk management and audit functions.

To the extent that the governance arrangements at global CCPs vary, they appropriately reflect the differences in products cleared, including type (and whether they are listed on-exchange or traded over-the-counter), market structure and legal/regulatory frameworks across jurisdictions. CCPs must tailor their ownership and governance structures to effectively address the specific risks and risk management challenges that may arise for a given CCP, particularly given the diversity in markets and regulatory frameworks.

CCP boards have mechanisms to obtain stakeholder input, and in many cases, the board's mandate explicitly includes contributing to the stability of financial system. CCPs strive for a diversity of opinion and relevant expertise to enhance decision-making, commonly maintaining committees with specific duties, such as finance, audit, and risk. A CCP’s board of directors – whether unitary or a two-tier board – is responsible for providing strategic direction and overseeing the activities of management at the CCP and is responsible for representing the interests of the shareholders.

As with many boards, CCP boards are comprised of a chair and other directors who often include commonly market participants as well as independent directors. The exact number of members and composition of the board will also depend on a number of factors including the relevant corporate law framework and CCP-specific regulatory guidelines. Board members are often chosen specifically to represent the ‘public’ or market participant perspectives, with independent directors also typically represented on the board to provide input and challenge to management.

One common practice is the establishment of standing risk committees composed of clearing members, clients of clearing members, and other experts to advise CCP management and the board. The use of such risk committees provide a venue for market participants to provide feedback to the CCP and is mandated by regulation in several jurisdictions.

Another important element of CCP governance is public disclosures. CCPs provide transparency by publishing their governance practices through committee charters and corporate governance documentation and rulebooks, disclosing information about their risk management framework, financial status, and operational procedures. This practice helps market participants make informed decisions, and includes other public disclosure frameworks. Entities apply for clearing membership with advance knowledge of the governance processes set out in disclosure frameworks, as well as an understanding of the CCP’s and regulator’s governance process for rule changes. These disclosure frameworks provide predictability and transparency, allowing clearing members to engage in advance planning and reducing uncertainty in the response to market developments.

Outlined in these disclosure frameworks are the rigorous risk management practices upheld by CCPs to assess and mitigate counterparty risk. They establish robust margin requirements, conduct stress tests, and have effective default management procedures in place to handle member defaults. CCPs also maintain contingency plans and business continuity measures in place to address various scenarios, including operational disruptions and extreme market events.

A layer of dedicated capital reserves (a tranche called ‘’Skin-In-The-Game,’’ or ‘’SITG’’) can further illustrate the commitment of a CCP, including its board, to risk management. Unlike a CCP’s default fund, SITG is not designed to be a significant loss absorption tool, but to ensure that a CCP has a stake in the success of its risk management practices. If utilised, a CCP’s SITG should be sized to be a large enough contribution to align the incentives of the CCP and its clearing members to conduct appropriate risk management, while not disincentivising clearing members from effectively managing risk or participating in the default management process.

A CCP’s governance arrangements are foundational to risk management, and CCPs also routinely identify, avoid, and mitigate conflicts of interest which could potentially impair the neutrality of the CCP. The governance arrangements CCPs apply embrace corporate best practices with specific arrangements that correspond with the function and responsibilities of CCPs within the wider economy. The WFE highlights that governance arrangements are tailored to the varying risk management challenges across jurisdictions and different CCPs, and that this diversity is important in maintaining stability in the broader financial system.

1. https://www.bis.org/publ/qtrpdf/r\_qt1512g.pdf [↑](#footnote-ref-2)
2. http://www.g20.utoronto.ca/2009/2009communique0925.html [↑](#footnote-ref-3)
3. https://focus.world-exchanges.org/articles/risk-default-governance [↑](#footnote-ref-4)