WORLD FEDERATION OF EXCHANGES

September 2017

CPMI-IOSCO Consultative Report:

Framework for Supervisory Stress Testing of Central Counterparties (CCPs)

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Background

The World Federation of Exchanges (WFE) is the global trade association for exchanges and clearing houses, representing more than 200 Market Infrastructure Providers, of which more than 100 are Central Counterparties (CCPs) and Central Securities Depositories (CSDs). Our members include exchange groups and standalone CCPs.[1]

Our members are both local and global, operating the full continuum of Financial Market Infrastructure in both developed and emerging markets. Of our members, 41 percent are in the Asia-Pacific region, 40 percent in EMEA and 19 percent in the Americas. WFE exchanges are home to nearly 45,000 listed companies, and the market capitalisation of these entities is over $67.9 trillion; furthermore, around $84.18 trillion in trading annually passes through the infrastructures our members safeguard.[2]

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. In the post-trade space, this is typically effected through our dedicated and active post-trade working group which has been in existence for the past two years representing the largest, as well as the smallest, CCPs across the globe.

The WFE shares regulatory Authorities' goals of ensuring the safety and soundness of the global financial system, which is critical to enhancing investor and consumer confidence, and promoting economic growth.

Introduction

The assured and central role that CCPs played in the 2008 financial crisis demonstrated to the G20 the systemic risk management benefits that CCPs provide. As such, in response to the crisis, G20 countries and other jurisdictions have been seeking to implement derivative market reforms to encourage – amongst other things – more centralised clearing in particular products and markets.

Markets are global, and as such it is only right that guidelines are designed at the global level to reflect this. The WFE welcomes well-designed international efforts to enhance and strengthen the principles of resilience of the financial system post-crisis and supports further initiatives which encourage that objective. Appropriate stress testing is one part of that.

The WFE has previously publicly expressed support for initiatives such as the CPMI-IOSCO Principles for Financial Market Infrastructure (PFMI) and the FSB Key Attributes, and has sought to proactively contribute to the international debate on these issues and others.[3] In doing so, its members have contributed significantly to the strengthening of the system via the implementation of many post-crisis initiatives, including efforts to encourage central clearing of derivatives as per the G20 direction.

The WFE and its members share CPMI-IOSCO's goals of ensuring the safety and soundness of the global financial system, which is critical to enhancing investor and consumer confidence, and promoting economic growth. In that context, we appreciate the opportunity to respond to this Consultative Report relating to CCP supervisory stress testing.[4]

[1] The WFE membership list can be found here
[2] As at end 2016
[3] - WFE: CCP Risk Management, Recovery and Resolution – Aligning CCP & Member Incentives – October 2015
- WFE: Response to CPMI-IOSCO Consultative Report on Resilience and Recovery of CCPs – October 2016
- WFE: Response to FSB Discussion Note on Essential Aspects of CCP Resolution – October 2016
- WFE: The Interplay Between Central Counterparty Recovery and Resolution: A Global Perspective – February 2017
- WFE: Response to FSB Consultative Document – CCP Resolution and Resolution Planning – March 2017
[4] CPMI-IOSCO Consultative Report: Framework for Supervisory Stress Testing of CCPs

Executive Summary

We welcome the initiative of CPMI-IOSCO to set out a framework for Authorities to use when designing and carrying out supervisory stress tests conducted by one or more Authorities.

Nevertheless, we generally note:

- A concern around information sharing and issues of confidentiality particularly for multi-jurisdictional stress testing (although acknowledging there generally are robust information sharing arrangements that can be used) and a need for engagement between regulators and by regulators with market participants;

- We caution against taking a one-size-fits-all stress test approach. As CPMI-IOSCO rightly recognises, not all aspects of a stress test will be relevant depending on the jurisdiction/market structure in which the CCP operates. We consider it preferable to have a small suite of stress tests to reflect the diversity within the CCP ecosystem;

- We believe the value of multi-jurisdictional stress tests sits at the macro-prudential level and as such are encouraged by the focus on macro-prudential stress scenarios and impacts, which should supplement the more targeted stress tests performed by each CCP; and

- Authorities should seek the expertise and input of CCPs when designing the stress tests to ensure relevance and that the scenarios are indeed plausible.

The following section further expands upon the views of the WFE membership.

WFE Comments

CCPs have performed well through a range of significant market stress events including the 2008 financial crisis and – more recently – in the global market volatility caused by various events in 2015 and 2016.

They have proven to be wholly resilient in stressed market conditions and – rather than become complacent – CCPs continue to work with regulators and market participants to further refine and improve their resilience and ability to manage future market crises.

Given the largely global and borderless nature of markets, we welcome unified and sensible international efforts to confirm the strength of the regulatory regime for CCPs and CCP risk management standards. The testing of CCP risk management regimes on a macro-prudential level can be a valuable additional tool in providing comfort to investors who participate in those markets.

As such, we welcome the initiative of CPMI-IOSCO to set out a framework for Authorities to use when designing and carrying out supervisory stress tests conducted by one or more authorities.

Given that context, our general comments include the following:

- We generally support the intention to design stress tests that look at wider, macro-impacts across a number of CCPs as opposed to looking at individual CCPs (or directly comparing CCPs). Market structures, and legal and regulatory environments, vary by jurisdiction. Ownership structures and business models vary by market. As such marking CCPs against each other would not be appropriate and we support the acknowledgement within the framework that not all stress scenarios would impact all CCPs in the same way;

- Each CCP has a large amount of expertise in the design and deployment of stress tests appropriate to its own market and situation. Macro-prudential stress testing should add value in supplementing those CCP-developed tests, but cannot replace or substitute them;

- Notwithstanding our support for these tests to consider the macro-view, and the indication that stakeholders (CCPs and data holders) should have the opportunity to input into the design of the data template, we think, so it is clear and unambiguous to all Authorities, there should be a clear statement in the report that all CCPs should explicitly have input on the design, whereas other stakeholders should have the opportunity to contribute on potential confidentiality issues; and

- Financial services organisations have a need and obligation to keep certain information private and confidential. We therefore welcome the focus on ensuring the confidentiality of data, that necessary information sharing agreements are in place, and the acknowledgement of the challenges of conducting cross-jurisdictional stress tests from a data privacy standpoint. Whilst acknowledging the appropriateness of other stakeholders having the ability to contribute on confidentiality issues with their data, we nevertheless caution that transparency in and of itself is not always appropriate nor in the interests of sound risk management.

Further, we have concerns in the following areas:

- Supervisory stress tests are one of many important elements to consider in the pursuit of improving (and monitoring) financial stability. However, risk models need to be robust and a realistic reflection of a given stress event, otherwise the robustness of the financial markets may be misinterpreted. It would not be appropriate for the results of one or a limited number of global macro-stress tests to drive risk management or financial resource standards;

- Testing scenarios should be based upon extreme but plausible scenarios as is usually the case. The plausibility of the assumption that a CCP will be unable to port customer positions depends on the local customer margin regime, the local customer porting construct and the severity of the scenario. Likewise, the assumption no payments will be made on the behalf of a defaulting participant's customers may or may not be plausible, depending on the scenario;

- The potential failure of custodians, collateral issuers, or settlement banks may be more relevant in a CCP's own stress testing framework. A supervisory stress test that aims at a macro-level to assess the stability of an interwoven financial system must ensure any plausible event is captured (accounting for the unique characteristics of the capital markets in which the CCP operates) and be clear that the CCP is not designed to guarantee portions of the banking system ancillary to their primary services, as this would not be practicable nor appropriate, and could yield implausible stress scenarios;

- We believe – as the proposal acknowledges - it critical that CCPs are consulted in the design of supervisory stress tests. However, it is unclear that any other supervisory stress test regimes exist where entities *not* subject to the stress tests can provide equally weighted input at the design stage. As such - to ensure consistency and achieve optimal results - we consider Authorities should primarily consult with CCPs on stress testing design rather than treating all stakeholders equally. Furthermore, we would encourage Authorities to coordinate stress testing exercises given (1) the complexity of the exercise, and (2) that some jurisdictions have already established cross-CCP stress testing exercises; and

- Feedback mechanisms are important. However, the results should only be used for the purposes intended; for example, they should not be used to drive additional individual CCP capital levels, nor trigger additional risk management changes or requirements. Further, whilst feedback during the testing would be helpful, any new framework elements should be incorporated into the testing procedure after the event, and not mid-test.

Conclusion

The WFE and its members are committed to ensuring their trading and clearing environments are secure, stable and resilient.

We welcome international efforts to enhance and strengthen the financial system through regulatory reforms that will – amongst other things – increase market confidence whilst reducing systemic risk. Investor confidence in public markets is crucial for the industry and, as markets evolve – and as G-20 mandates continue to be implemented encouraging greater central clearing of financial markets – legislators and operators of market infrastructure should continue to work together to ensure risks are appropriately mitigated without undue or unintended consequences.

Ultimately, we are working towards the shared objectives of achieving fair, robust and resilient markets in which investors can have confidence. In that regard, the WFE and its members – via its dedicated post-trade working group of CCP technologists and risk specialists - are keen to continue working with international authorities to ensure this.

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