

Does the market need a central counterparty?

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08 September 2016

Outline

- What is a CCP?
- Risk Management
- Why would you want a CCP?
- Is a CCP easy to implement?

What is a CCP?

- Institution for managing risks in capital markets
- After the trade is done, CCP takes on obligations of the buyer and seller
- A CCP's primary relationship is with its clearing members
- CCP monitors its risk exposure and holds collateral and capital against it...
- ... and manages a default if it happens

Risk management - components

- Legal basis
- Default management procedures
- Membership criteria
- Margin system
- Clearing fund
- Capital of the clearing house (or equivalent)

Margin

CPSS - IOSCO PMFI6 states - A CCP should cover its credit exposures to its participants for all products through an effective margin system that is risk-based and regularly reviewed.

Margin - components

- Initial Margin
- Variation Margin

Margin - Initial Margin

- Initial Margin is a calculation of the cost to the clearing house of closing out a position/portfolio of a clearing member in the event of the clearing member defaulting

Initial Margin - methodologies

- SPAN - analyses a portfolio against a set of numeric values that indicate how a contract will gain or lose value under various scenarios.
- Value at Risk (VaR) - is the maximum loss not exceeded with a given probability defined as the confidence level, over a given period of time.

Margin - Variation Margin

- Variation Margin is the realisation of daily profit and losses on a position/portfolio.
- If the value of a position moves against a member, then the member pays the value of the loss to the CCP
- If the value of a position moves in a member's favour, then the CCP pays the profit to the member

Risk Management - clearing fund

- Fund is used if there is not enough margin to meet the losses following a default
- Contribution to fund is made by clearing members and the CCP
- Size of fund depends on the amount and the risk of the business cleared by the CCP

Why would you want a CCP

- Best practice - well managed CCP assists in meeting CPMI-IOSCO PFMI
- CCP's are becoming the standard for risk management in global markets
- Netting efficiency - having a CCP reduces load on CSD
- Centralises risk in the market
- Essential to allow introduction of derivatives

How easy is it to
implement a CCP?

Building a CCP is
NOT
just an IT project!

Typical program

Determination

Planning

Implementation

Engagement with stakeholders

Ideal programme - Determination

- Determine need or opportunities for CCP
- Identify legal and regulatory issues
- Identify other road blocks
- Identify and engage with key stakeholders
- Confirm level of support

Ideal programme - Planning

- Appoint dedicated team
- Develop market model
- Determine and obtain commitment of financing
- Identify staffing needs
- Develop requirements
- Develop RFP for necessary system
- Engage with stakeholders

Ideal programme - Implementation

- Confirm financing
- Choose system supplier
- Develop rules, regulations, agreements
- Find Clearing Members
- Engage with and educate stakeholders
- Install systems
- Undertake internal and market testing
- Undertake training
- Obtain regulatory approval

Factors that have largest impact on timing

- Legislative changes
- Rules, regulations and regulatory approval
- Systems implementation and testing
- Obtaining Clearing Members
- Member readiness

Realistic timings

- Determination - 3 - 6 months
- Planning - 6 months
- Implementation - 9 - 18 months

Costings - major components

	Up front costs	Recurring costs
Legal and regulatory - law changes - developing rules and regulations - obtaining regulator approval	\$0.5 - 1.0 mn	<\$0.5 mn
Systems	\$1.0 - 5.0 mn	20 - 25%
Staffing (risk management, operations, member relations, marketing)	\$0.5 - 1.0 mn (depending on local market)	\$0.5 - 1.0 mn (depending on local market)
Initial financing of clearing fund	?	?
Capital of the CCP	?	?

Questions?