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Central Counterparties and Systemic Risk

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Overview

1. CCPs High on Regulatory Reform Agenda
2. CCP Risk Management Challenges
3. The Way Forward



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CCPS HIGH ON REGULATORY REFORM AGENDA



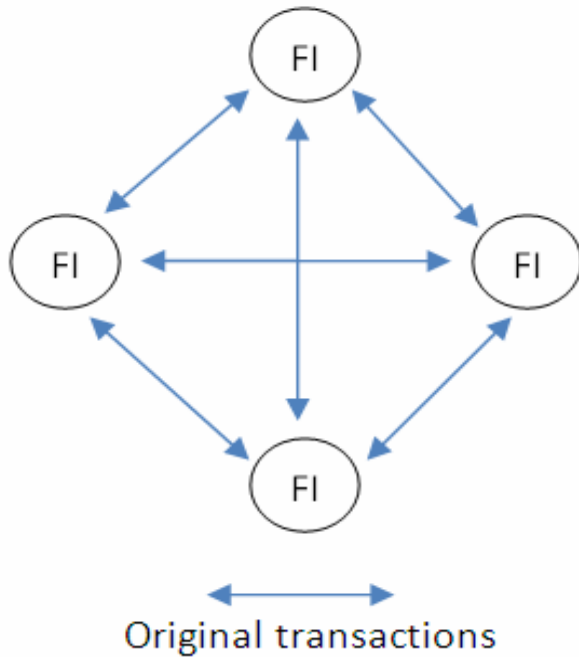
Lessons from the Crisis

- Counterparty credit risk aversion can freeze markets
- Jumps in margin requirements add to market turbulence
- Default management is essential for managing contagion risks

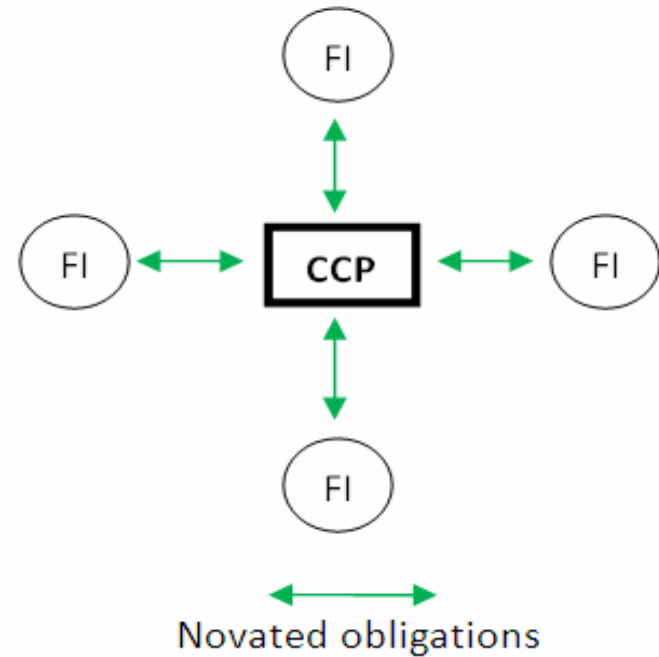


How CCPs can help

Bilateral Arrangements



Central Clearing





How CCPs can help

- **Enhanced counterparty credit risk management**
- **Enhanced netting decreases participants' credit and liquidity risks**
- **Shock absorption – Robust default management mechanisms can reduce probability of contagion**



Regulatory reform already underway

- Many countries have already, or are in the process of, mandating the use of CCPs for certain instruments
 - EU, Japan, US
- Strong commitment from G20 Leaders (Pittsburgh Summit)
 - Trade standardized OTC derivative contracts on exchanges or electronic platforms
 - Clear standardized OTC derivatives contracts through CCPs by end-2012
 - Report OTC derivative contracts to trade repositories
 - Impose higher capital charges for non-centrally cleared contracts



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CCP RISK MANAGEMENT CHALLENGES



CCPs have the same challenges an FI ...

- Counterparty credit risk
- Valuation risk
- Liquidity risk
- Operational risk
- Banker risk
- Legal risk



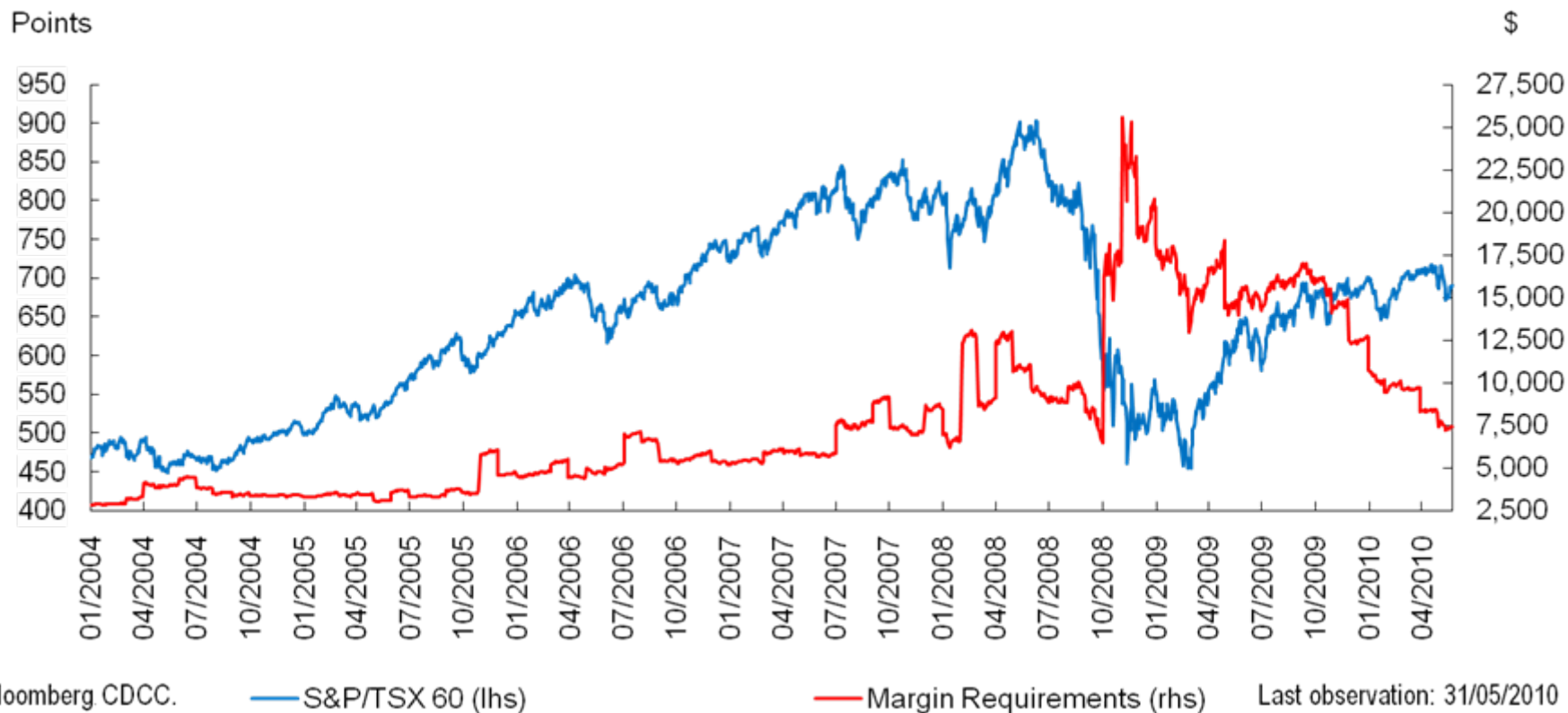
... but, CCPs are also becoming large and central ...

- CCPs risk management practices should not inadvertently undermine functioning of markets
 - Margin requirements should not add to instability
 - CCPs' discretion in managing a default should promote system stability
 - Need to be able to resolve non-viable CCPs.



Margin requirements should not add to instability

Margin Requirements Associated with the SXF – S&P/TSX 60 Index Futures.





CCP Discretion should promote system stability

- CCP management of a member default in times of market stress is complex
- Discretion provides a CCP with the flexibility to take action
- A framework around use of discretion should strike a balance between safeguarding interests of CCP and surviving members while promoting financial stability more broadly



Need resolution mechanisms to address non-viable CCPs

CCPs can fail

- How much capital should a CCP hold?
- Credible ex-ante plans for raising additional capital should it fall below minimums
 - Exit or transition plans for non-viable CCPs that minimize systemic disruptions



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THE WAY FORWARD



What are we doing in Canada?

- Building a CCP for repo transactions
- Working towards a CCP solution for OTC Derivatives



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Summary and Thank you