

**Remarks of Jeffrey M. Bandman<sup>1</sup>**  
**Acting Director, Division of Clearing and Risk**  
**Global Risk Management Forum, June 23, 2016**  
**New York, NY**

Thank you Stephan so much for that warm introduction.

It is a pleasure to join so many risk experts from around the world gathered here to discuss these important topics. I am very pleased to see such a mix of economists, quants, lawyers and compliance specialists to bring a range of perspectives.

Today's timing is notable, as the British people go to the polls to vote on their relationship to Europe. Regardless of today's outcome, the attention to that vote, the preparations so many of us have made and the impacts we have already seen show the interconnectedness of the financial system and its attendant risks.

**CCP Safeguards and Risks**

In my remarks today, I will be focusing on safeguards and risks relating to clearing and to central counterparties, or CCPs. Clearinghouse strength and resilience is more important than ever. It is an area where collaboration across the globe has been immensely beneficial. I can think of no more important issue – and no better topic to discuss at this Global Risk Management Forum. So today, I'd like to share a few thoughts:

- on current international developments;
- on CCP recovery and resolution;
- on the prospect of a “macroprudential” approach to CCPs, including supervisory stress tests;
- on what's new in customer protection; and

---

<sup>1</sup> The remarks in this speech reflect solely the personal views of the author, and do not necessarily represent the views of the Commodity Futures Trading Commission, the individual members of the Commission, or its Staff. This speech and the accompanying materials are work product prepared by an employee of the U.S. Government as part of his or her official duties, and are therefore in the public domain. Pursuant to 17 U.S.C. § 105, this speech and the accompanying materials are not eligible for copyright protection and may be used and disseminated in other venues by other parties.

- on opportunities and threats associated with new technology.

And then I'd be pleased to take any questions.

### **Progress in Implementing Clearing Mandates**

As you know, a key component of the G-20 leaders' framework to reform the over-the-counter swaps market in 2009 was to mandate central clearing of standardized swaps. We have made great progress in the implementation of that commitment in just a few short years.

In the United States, clearing is now mandated for most interest rate and credit default swaps. Today, approximately 75 percent of swap transactions are being cleared, as compared to only about 15 percent in 2007. The implementation of Europe's mandate began just this week, and the mandates of other jurisdictions are taking, or will soon take, effect.

And just two weeks ago, the CFTC proposed new clearing mandates for interest rate swaps denominated in the currencies of several additional jurisdictions. These are mainly jurisdictions that have mandated clearing or are expected to do so soon. They include Australia, Canada, several European Union countries, Mexico, Hong Kong, Singapore and Switzerland. And in many of those jurisdictions, this proposal would make our clearing requirement consistent with those that already have been proposed or finalized. This proposal is open for public comment and we welcome your feedback.

This is an important step that will bring further standardization and transparency to the swaps market, while reducing risk within the system. It brings us closer to realizing the agreement of the G-20 leaders. And it is another significant step in harmonizing our requirements with our counterparts abroad.

### **The Importance of Clearinghouse Resilience**

This very progress has made it even more imperative that we make sure clearinghouses are strong and resilient.

Some have raised concerns about whether this new emphasis on central clearing is creating new concentrations of risk within the financial system. I would first

note that significant work has been done to increase the resilience of CCPs. The development of the PFMI itself was a major advance in addressing CCP resilience. And this has been supplemented by subsequent guidance, including guidance on Recovery of Financial Market Infrastructures and on quantitative disclosures, as well as the FMI Annex to the Key Attributes dealing with CCP resolution.

Some of the more frequently voiced concerns include the following:

- Are the PFMI sufficiently detailed? Should more granular guidance be given?
- What are the appropriate tools for recovery, and who should be at the table when decisions must be made regarding recovery?
- What are the necessary and appropriate powers for a resolution authority? When should a resolution authority intervene?
- What are the interdependencies between clearinghouses, systemically important clearing members, and their affiliates? This is particularly of concern because the largest members are often active at multiple clearinghouses, and they or their affiliates may be providers of services to clearinghouses, such as liquidity facilities payment and settlement services or other services.
- Do we need a greater “macroprudential framework” when it comes to CCP regulation? What might a macroprudential approach entail with regard to stress testing, margin or the clearing ecosystem?

I believe that it is possible to devise good, pragmatic approaches to all of these concerns, and I believe we have already accomplished a great deal in that regard. So I would like to briefly highlight how far we’ve come, and then offer some thoughts on where we are going.

### **CFTC’s Domestic Efforts**

In the United States, the CFTC’s Division of Clearing and Risk (DCR), which I run, has been involved in the oversight of clearinghouses for many years. And since the global financial crisis, we have been particularly focused on the resiliency of clearinghouses.

We have substantially strengthened our requirements regarding risk management and transparency. We did an extensive revision of our rules and incorporated

international standards—the Principles for Financial Market Infrastructures, or PFMIs-- into our regulations. We strengthened customer protection measures – I will return to this subject later. And we have enhanced our examination, compliance, and risk surveillance programs.

We are actively working on recovery planning and the adequacy of resources and procedures applicable in the event of a major problem. This includes exploring how clearinghouses implement auction procedures to increase efficiency and participation; considering under what circumstances and to what extent gains-based haircutting is an appropriate tool to allocate losses; examining the tools available to a clearinghouse, such as juniorization and partial tear-ups, in order to ensure that they can re-establish a matched book; and discussing the governance mechanisms over the use of recovery tools – and the transparency regarding the potential use of those tools. Over the remainder of this year, we will be closely reviewing proposed recovery rule filings as well as recovery plans from our major clearinghouses. We held a public roundtable on these subjects last year, and I expect we will soon be providing some public guidance in this area as well.

***Resolution Plans Must Be Designed to Encourage Recovery.*** We are also working actively with other U.S. regulators on resolution planning. To this end, we held a joint tabletop distressed CCP simulation exercise this past spring. My DCR colleagues and I will be making a joint presentation with the FDIC on CCP resolution at the CFTC’s Market Risk Advisory Committee this coming Monday, June 27. This is open to the public and I encourage you to watch or attend.

Recovery and resolution planning are seen as a continuum: if a CCP cannot get back to a matched book and replenish its resources through recovery tools, then authorities may choose to invoke a resolution plan. Resolution may also be invoked if the resolution authority determines that the use of available recovery tools is likely to compromise financial stability.

Resolution does not mean liquidation in this context, but rather a phase where a government authority with certain resolution-related powers steps in to ensure the continuity of critical functions. Much of the discussion of resolution focuses on questions like: at what point should a resolution authority intervene? Should there be specific tools and resources reserved for exercise by the resolution authority in the resolution phase? What is the proper balance between giving the resolution authority flexibility and having predictability regarding tools, potential assessments, or other features? Should there be a “presumptive path” for the

Final -- As Prepared for Delivery

actions of a resolution authority, or “constructive ambiguity” as to what it may do and when? If resolution is invoked to avoid the use of recovery tools that might compromise financial stability, how can we ensure that the resolution authority’s use of its own tools won’t have a similar effect?

These are appropriate questions to ask. And in addressing those issues, we must remember that the incentives that may be created by resolution plans — intentionally or not — can create or affect recovery prospects. If, for example, clearing members believe they will get a better outcome in resolution than in recovery, then they may have an incentive not to facilitate recovery. That is, they may be less willing to step up to bid in an auction or take on positions of a defaulting member if they think that under resolution, they would absorb fewer losses or improve their economic or governance rights in the CCP. They may not be as willing to support replenishing a CCP’s resources in recovery if in resolution they expect to get more in return for doing so. So our resolution planning must not create incentives that undermine recovery.

## **International Efforts**

Internationally there has been great progress as well.

One important example of international cooperation was the recent agreement the CFTC reached with the European Commission this past February, which sets forth a transatlantic “common approach” regarding requirements for CCPs. This agreement resolved the issues that were standing in the way of Europe “recognizing” U.S. CCPs. And it thereby helps to make sure that the U.S. and European derivatives markets can continue to be dynamic, with robust competition and liquidity across borders. It provides for some modest changes on both sides of the Atlantic that will help bring our regimes closer together and reduce the possibility of regulatory arbitrage.

Since that announcement, we have lived up to our end of the bargain, as the CFTC issued a comparability determination in March. This established a substituted compliance framework for EU CCPs, so EU CCPs can demonstrate compliance with discrete aspects of our regime by complying with provisions under their own laws. And most recently, the first formal recognition of a US clearinghouse by the European Security and Markets Authority, or ESMA, was announced just last week, with respect to CME Clearing.

Final -- As Prepared for Delivery

Another example is our work on exemptions from CFTC registration for CCPs located outside the United States that wish to clear proprietary swaps trades for U.S. clearing members and their affiliates. Last year the CFTC granted clearinghouses located in Australia, Japan, South Korea and Hong Kong this “Exempt DCO” status.

And earlier this month, DCR issued a no-action letter to Shanghai Clearing House. This will allow Shanghai Clearing to temporarily clear swaps subject to mandatory clearing in China for proprietary trades of US clearing members and their affiliates. This marks the culmination of months of work among staff of the CFTC, Shanghai Clearing and the People’s Bank of China. This relief is designed as an interim measure, as Shanghai Clearing intends to apply soon for Exempt DCO status.

### **Multilateral Work on CCP Resilience, Recovery and Resolution**

There is much more going on with respect to CCP resilience across borders internationally. As many of you know, last year the chairs of the Financial Stability Board’s Supervisory and Regulatory Cooperation Committee and Resolution Steering Group, the Committee on Payments and Market Infrastructures (CPMI), the International Organization of Securities Commissions (IOSCO) and the Basel Committee on Banking Supervision agreed to a CCP work plan that has four major elements. We are co-chairing some of this work and participating in all of it.

The first element involves examining whether more granular regulatory standards should be issued to increase CCP resilience, such as the standards on margin methodologies and the resources available to a clearinghouse in the event of a default. The second is to assess the adequacy of standards and guidance for CCP recovery tools and plans. The third is developing standards for credible resolution plans. And the fourth element is examining the interdependencies between and among CCPs and large clearing members.

There will be public reports on these workstreams, beginning later this summer with reports on the resilience issues.

All this work covers many issues worthy of discussion at this conference and elsewhere. I cannot cover them all, so let me highlight a few key considerations.

Final -- As Prepared for Delivery

***Daily Risk Management is the Key to Resilience.*** While we need to plan for recovery and resolution of a clearinghouse, we must remember that clearinghouse resiliency is primarily about daily risk management. Often times, the activities that comprise ongoing risk management don't get much attention when we talk about clearinghouse resiliency. But those activities, carried out by the clearinghouse, clearing members and regulators, are essential. I'm referring to daily margining practices, stress and back testing, oversight, and ongoing risk surveillance. No recovery plan — and no set of rules — can take the place of these everyday activities. And because these activities involve the clearinghouse and its members—which do not always have identical interests and incentives — transparency and proper governance around these issues are critical also.

***Is There a Need for A Greater Macroprudential Framework?*** There has been some attention paid recently to whether we need a greater “macroprudential framework” for CCP regulation. Generally, this refers to regulation with the objective of mitigating systemic risk, and with a scope that includes the financial system generally, rather than a focus on individual entities.<sup>2</sup>

First I would note that macroprudential considerations are already present in CCP regulation.

For example, the PFMLs require a CCP to have robust risk controls and contingency plans that are appropriate to promote CCP's ability to operate in a safe and sound manner during a stress event or a participant default, and to minimize the risk of widespread disruptions to the larger financial system. And I think much of the international work currently going on regarding CCPs will further address these concerns.

### **“Supervisory Stress Tests”**

One element of a “macroprudential approach” involves the notion of supervisory stress tests. These are sometimes referred to as “regulatory stress tests”. By either name, these would be stress tests that consider the impact of the

<sup>2</sup> See e.g. interview with Benoît Coeuré, Risk, May 19, 2016 <http://www.risk.net/risk-magazine/interview/2458517/interview-ecb-s-beno-t-c-ure-on-ccp-capital-and-stress-testing>; Benoît Coeuré, Towards a macroprudential framework for central counterparties, June 6, 2016

Final -- As Prepared for Delivery

propagation of stressful events across multiple clearing members at multiple CCPs. An example might be looking at the impact of simultaneous extreme but plausible movements in equity indices, energy prices and interest rates – applied across all the CCPs included in the stress tests. These would therefore highlight systemic impacts, as well as interdependencies across CCPs and their clearing members. Developing this type of framework should be a worthwhile priority both domestically and internationally. My division looks forward to contributing to this work.

I would note that this approach is different from the idea of a one-size-fits-all stress test to measure all individual CCPs against. No two CCPs are exposed to the same sources of risk.<sup>3</sup> The CCPs supervised by the CFTC range from highly diversified to highly specialized in their mix of products and asset classes. I have trouble seeing the utility of this sort of one-size-fits-all “standardized” stress test for CCPs; indeed such an approach may produce misleading outcomes.

### **Antiprocyclical**

It has also been postulated that a macroprudential approach should focus on the impact of CCP margin practices on “procyclicality” in the system. Conceptually, this would involve maintaining stable and conservative margins that would not fall too low in benign times, and would not be increased sharply in stressed conditions. A concern typically expressed involves a scenario where a CCP facing a certain risk needs to increase its margins – clearly prudent from a risk management perspective. The impact of increased margins on clearing members may be “procyclical” in calling for more collateral, perhaps rapidly, at a time when resources are scarcer or more costly.

Measures to combat procyclicality are sometimes referred to as “antiprocyclicality” measures – quite a mouthful!! or “APC measures” for short.

It has also been suggested that CCPs should measure procyclicality by using quantitative metrics, that they should include considerations related to procyclicality or APC in their margin model validation practices, and that they should use also quantitative metrics in assessing the effectiveness of their margin practices from an APC perspective.

---

<sup>3</sup> See David Bailey, Central Clearing: setting the regulatory bar, p. 5  
<http://www.bankofengland.co.uk/publications/Documents/speeches/2016/speech905.pdf>



















Like this slideshow? Why not share!

- Share
- Email
- 
- 
- 
- How to Become a Thought Leader in Y...[How to Become a Thought Leader in Y... by Leslie Samuel 297083 views](#)
- Visual Design with Data[Visual Design with Data by Seth Familian 271928 views](#)
- Designing Teams for Emerging Challe...[Designing Teams for Emerging Challe... by Aaron Irizarry 124169 views](#)
- UX, ethnography and possibilities: ...[UX, ethnography and possibilities: ... by Ned Potter 262863 views](#)
- Winners and Losers - All the (Russi...[Winners and Losers - All the \(Russi... by Ian Bremmer 75714 views](#)
- Study: The Future of VR, AR and Sel...[Study: The Future of VR, AR and Sel... by LinkedIn 190385 views](#)