ISDA Publishes Best Practice Recommendations for CCPs

NEW YORK, January 24, 2019 – The International Swaps and Derivatives Association, Inc. (ISDA) has published a set of best practices for central counterparties (CCPs), aimed at ensuring greater consistency in risk practices at CCPs across the globe.

The recommendations follow a default at Nasdaq Clearing last September, which exceeded the defaulting member’s margin and default fund contribution and required the use of mutualized resources – the second such event in five years. The paper highlights steps that can be taken to minimize the potential for a member default to impact other members and the financial system as a whole, except in an extreme stress event.

The paper recommends that CCP risk management decisions are based on the risk profile of a product, rather than on whether a derivative is an exchange-traded or over-the-counter product. Other best practice recommendations include ensuring CCPs have risk controls and margin requirements that adapt to concentration, liquidity, member credit quality and wrong-way risk in a member’s portfolio. CCPs should also have effective and transparent default management processes and robust membership criteria.

“ISDA and its members support clearing as an effective tool for mitigating counterparty credit risk, and this is reflected in the fact that 88% of US interest rate derivatives trading volume was cleared in 2018. As clearing volumes continue to grow, it is more important than ever that CCPs adhere to a consistent set of robust risk management best practices,” said Scott O’Malia, ISDA Chief Executive.

The paper sets out the following best practices:

- Risk management must be aligned with the underlying risk of a given product;
- CCPs must have robust membership requirements that are regularly reviewed;
- Products cleared by a CCP must be sufficiently standardized and liquid;
- CCPs must ensure they have a sufficient number of members to mutualize risk;
- Margin must be calculated consistently across all products, taking account of concentration, liquidity and wrong-way risk;
- Controls should be used to protect against erroneous trades and the build-up of concentrated positions;
- Key documentation must be disclosed, including margin and stress testing models and default management procedures;

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The size of the default fund should be aligned with key best practices, with limits on the portion of the default fund that can be consumed by any one member;

- The default management process should include key elements – for instance, ensuring sufficient participation in auctions – and should be tested regularly;

- Parties underwriting the counterparty risk of a CCP should be part of its governance.

The CCP Best Practices paper is available on the ISDA website.

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About ISDA
Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 69 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association’s website: www.isda.org. Follow us on Twitter @ISDA.

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