



Discussion on “Money Illiquidity” and “Assessing the Safety of Central Counterparties”

OCTOBER 21, 2021

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Papers for discussion

- D. Livdan, N. Schürhoff, and V. Sokolov. *Money Illiquidity*
- M. Paddrik and H. Peyton Young. *Assessing the Safety of Central Counterparties*

Money illiquidity— Background

- Payment systems are **critical components of the financial system**, facilitating the transfer of funds between and among participants
- Disruptions in payment system functioning can cause money “illiquidity” with **spillover effects on the real economy**
- Since such spillovers are rare, little effort has been put into studying the possible consequences should payment system disruptions negatively affect economic activity
- Traditional banking models, therefore, assume **frictionless payment systems**

Money illiquidity— Authors contributions

- Use **transaction-level data** from the Russian payment system to quantify how payment system disruptions can affect the real economy
 - ▶ Banking crisis in 2004 disrupted 50% of interbank connections
- Develop **equilibrium model** of customer and supplier firms in which these disruptions propagate and affect firm growth
 - ▶ Allows for the *quantification* of a given **firm's resilience**
- Show theoretically/empirically that illiquidity spillover effects occur through (i) *loss of payment access*, and (ii) **shock amplification** from *payment network externality*
- Payment shocks can have **persistent deleterious effects** on a firm's revenue growth and are more severe the more central a firm is in the payment network

Money illiquidity— Points for consideration

- Equilibrium model captures a network of customer and supplier firms in a multi-firm production economy in which payment shocks propagate
 - ▶ Q. How far downstream can we expect payment system disruptions to reach?
Could households even be affected by such disruptions?
 - ▶ Q. What extensions and/or further considerations to the model could improve the fruitfulness of results?
- Effects from payment system disruptions depend on payment network centrality
 - ▶ Q. Should regulators pay greater attention to a given firm's position in the payment network?

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Assessing the safety of Central Counterparties— Background

- Regulatory reforms put in place after the GFC have caused CCPs to become *large, central, and critical nodes* in the global financial network
 - ▶ Benefits include increased transparency, product standardization, and netting benefits for market participants
 - ▶ However, this comes at the cost of creating **single points of failure**
- CCPs' systemic nature highlights the importance of properly assessing their ability to cope with financial stress
 - ▶ Directly related to individual CCP's risk management frameworks
 - ▶ Has consequences for possible **contagion effect in case of CCP default**
- Covid crisis has put **CCP margin practices**,¹ as well **recovery and resolution**² at the forefront of the agendas of SSBs³

1. CPMI press release, May 2021. [BCBS, CPMI and IOSCO survey clients and non-bank intermediaries on margin calls](#).

2. FSB, January 2021. [FSB Work Programme for 2021](#).

3. FSB, November 2020. [Holistic Review of the March Market Turmoil](#).

Assessing the safety of Central Counterparties— Authors contributions

- Authors use (mostly) **publicly-available data** to assess CCP risk levels using three metrics based on the probabilities of:
 - ▶ *IM breach*. Likelihood of margin call > IM held
 - ▶ *Guarantee Fund (GF) breach*. Likelihood of IM breach > CCP capital + GF
 - ▶ *CCP default*. Based on GSIB CCP CM reports to Federal Reserve (confidential)
- Introduce **CCP Stress Index**—similar in spirit to the LCR—which assesses GF’s ability to meet obligations in case of member default
 - ▶ Indicator **could be used to calibrate CCP Guarantee Funds**
- Authors find **heterogeneity in computed metrics across CCP size and jurisdiction**, and substantial breach increases in Q1 2020 due to the covid-induced market stress

Assessing the safety of Central Counterparties— Points for consideration

- Authors' work shows the fruitfulness of accurate and readily-available public data
 - ▶ Q. What improvements/changes could be made to publicly-available information to further increase its usefulness for policy makers?

- An important piece of the puzzle is often missing in discussions of CCP resilience
 - ▶ Q. How can we properly assess CCP riskiness without the explicit consideration of the capacity of CMs and their clients to source liquidity to meet margin calls?

 - ▶ Q. Does the highly interconnected nature of the network of CCPs, CMs and clients require us to take a more macro look at the risk posed by these infrastructures and not simply tweaking the risk management frameworks of individual CCPs?