Committee on Payments and
Market Infrastructures

BANK FOR INTERNATIONAL SETTLEMENTS

OICU-IOSCO

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Clearing of deliverable FX instruments

1 The CPMI and IOSCO are issuing this statement in light of industry developments with respect to CCP clearing of deliverable FX instruments and the associated models for effecting their settlement. The statement applies only to the clearing of deliverable FX instruments by CCPs.

2 The clearing of deliverable FX instruments involves the simultaneous settlement of obligations in more than one currency. In meeting its obligations under the CPMI-IOSCO *Principles for financial market infrastructures* (PFMI)[1], a CCP is not obliged to use any particular settlement process for deliverable FX instruments and can use 'paired settlement' arrangements whereby a CCP assigns bilateral delivery obligations between participants.[2] However, irrespective of the settlement process used, the CCP shall remain responsible for that process and for ensuring that it satisfies the PFMI. Additionally, participants need to be able to understand and manage any bilateral risks that might arise during settlement.

3 According to PFMI 7, a CCP intending to clear deliverable FX instruments should ensure that it maintains sufficient qualifying, highly reliable liquid resources to cover, on time, liquidity shortfalls that could arise in the settlement of cleared transactions in all settled currencies in default scenarios. This should include, at a minimum, the default of the participant and its affiliates that would generate the largest aggregate liquidity obligation in extreme but plausible market conditions.

4 The qualifying, highly reliable liquid resources may include rules-based liquidity arrangements between a CCP and its participants that provide liquidity resources equivalent to committed lines of credit, committed foreign exchange swaps and committed repos. As part of these qualifying liquidity arrangements, participants commit, within pre-defined limits and pre-agreed terms and conditions, to lend or sell to the CCP the relevant currency in order to provide the liquidity necessary to complete same day settlement in the correct currency. This includes arrangements whereby participants swap, with the CCP, the currency owed to them by the CCP for the counter-currency they would have delivered to the CCP.

5 CPMI and IOSCO expect CCPs, irrespective of the settlement model used, to ensure the same level of confidence in the completion of same day settlement of obligations on the originally specified settlement date, irrespective of whether a potential liquidity shortfall on default relates to the obligation of the CCP itself or to obligations of one participant to another. In the paired settlement model, this may include arrangements whereby participants agree within pre-defined

1 http://www.bis.org/publ/cpss101.htm

2 It is, however, a fundamental feature of central clearing that transactions between different direct participants (clearing members) can be cleared through the CCP. A model in which there are only transactions between indirect participants (clients) of the same direct participant and/or transactions between direct participants with their own indirect participants is not compatible with the PFMI.

limits and pre-agreed terms and conditions to swap the currency owed to them by their paired counterparty for the counter-currency they would have delivered to that counterparty.

6 Regardless of the settlement model used, a CCP must conduct appropriate due diligence on its participants' ability to understand, quantify and manage the associated contingent liquidity obligations under its rules; the CCP must identify the point at which other qualifying liquid resources would be exhausted and any rules-based arrangements would need to be invoked. CPMI and IOSCO would expect the terms and conditions around such arrangements to be set out in rules or other contractual documentation agreed between the CCP and participants; and to ensure the provision of information sufficient to enable the appropriate identification, control and mitigation of risks in the system by all parties involved.