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## Central Counterparty Default Waterfalls and Systemic Loss

*OFR WP 20-04*

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### Abstract


Central counterparty default waterfalls act as a last line of defense in over-the-counter markets by managing and allocating resources to cover defaults of clearing members and clients. However, central counterparties face competing objectives in setting up their default waterfalls. In this paper we evaluate the trade-offs between default waterfall resiliency and central clearing, using a unique and comprehensive dataset containing all U.S. cleared and bilateral credit default swap positions. We evaluate the resiliency of different waterfall designs, accounting for the interconnectedness of payments in the system, the presence of client clearing obligations for members, and the distribution of losses among market participants.

**Keywords:** central counterparty, systemic risk, default waterfall, financial networks, credit default swaps

**JEL Classification:** G10, G23, G28, L14

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