

In Focus 3: Changes in the Local Peso/Dollar Spot Market

Some of the components to mitigate risk in the clearing and settlement of transactions on the peso/dollar spot market¹ have changed. First, the limit on the maximum net short position² (or net dollar selling position) a participant may have during the day has changed over the last two years. On the other hand, because of the merger between the Cámara de Compensación y Liquidación de Divisas de Colombia S.A. (CCDC) and the Cámara de Riesgo Central de Contraparte de Colombia S.A. (CRCC), these transactions went from being cleared through a foreign exchange clearing and settlement system to being cleared by a central counterparty risk clearing house, an entity that interposes itself between the original counterparties through the novation mechanism.³

Described and analyzed in this section are the changes in the dollar values cleared, in the number of transactions and in the number of participants. These changes were caused by three events that occurred during the last two years. The first is the decline in the short position limit (SPL), the second involves substitution of the type of financial infrastructure that clears and settles transactions in this market, and the third pertains to an increase in the SPL.

Tables A and B show separately the values corresponding to the transactions that were traded with compliance the same day (97.5 % of the market) and those where compliance occurred within three days of the trading date (2.5 % of the market). It shows the daily average gross and net dollar values, the number of transactions and the number of market participants with same-day and next-day compliance (t + 1 to t + 3), for the first two months of 2020. Additionally, the percentage differences are included for the periods in which the changes occurred, considering that the variations correspond to the comparisons between the period of each row and the immediately preceding period.

At the beginning of 2020, peso/dollar spot market transactions were cleared through the CCDC (without interposition between the parties), and the SPL was set at USD 80 million (m). The gross and net multilateral settled values on an average daily basis came to USD 1,515.97 m and USD 164.18 m, respectively, and the number of transactions and the number of active participants were 1963 and 33, in that order.

In March 2020, the CCDC lowered the SPL by USD 15 m through an adjustment in one of the parameters for calculating the SPL.⁴ This change remained effective until February 2021. During that period, there were variations in transactions with t + 0 complian-

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- 1 In accordance with External Resolution 1 of 2018, the periods covered by the foreign exchange spot market are from t + 0 to t + 3.
 - 2 If a participant is required to sell more than this limit, it would be necessary to prepay the multilateral obligations for at least the value that exceeded the limit.
 - 3 Novation is understood as the mechanism whereby a central counterparty clearing house becomes the buyer of every seller and the seller of every buyer. Therefore, the original relationship between the parties is eliminated.
 - 4 To mitigate liquidity risk stemming from default by its two main liquidity providers that are simultaneously active participants in dollar sales, the CCDC established the SPL as the total of pre-agreed credit lines minus the two largest credit lines in dollars. By March 2020, the sum of the lines was USD 120 m and the two largest lines totaled USD 55 m.

Table A
Behavior of Volumes and Amounts in Response to Changes in the Short Position Limit and with Novation of Transactions with Same-day Completion

Period	Settlement t + 0 (daily average)				Type of clearing and value of short position limit
	Gross value (millions of dollars)	Net value (millions of dollars)	Number of transactions	Number of clearing members	
20201 - 20202	1,515,971,659.21	164,178,850.00	1963	33	Clearing without interposition SPL USD80 m
20203 - 20211	-20.6%	27.5%	-26.2%	-1	Clearing without interposition SPL USD65 m
20212 - 20219	4.2%	6.2%	13.3%	-1	Clearing with interposition SPL USD 65 m
202110 - 202112	9.4%	24.8%	7.2%	-0	Clearing with interposition SPL USD 80 m

B. Behavior of Volumes and Amounts in Response to Changes in the Short Position Limit and with Novation of Transactions with Completion between One and Three Days

Period	Settlement Next day (daily average)				Type of clearing and value of short position limit
	Gross value (millions of dollars)	Net value (millions of dollars)	Number of transactions	Number of clearing members	
20201 - 20202	210,419,927.87	162,112,238.14	68	24	Clearing without interposition SPL USD80 m
20203 - 20211	-48.0%	-48.3%	-48.8%	-10	Clearing without interposition SPL USD65 m
20212 - 20219	-11.2%	3.7%	-11.8%	-1	Clearing with interposition SPL USD 65 m
202110 - 202112	16.9%	14.1%	40.3%	1	Clearing with interposition SPL USD 80 m

Source: CRCC. Calculations by Banco de la República.

ce; namely, reductions in the gross value of cleared transactions and in the number of transactions (20.6% and 26.2%, respectively), one less active participant, and an increase of 27.5% in multilateral net values. This last variation coincides with the increase in the National Treasury Department's participation in the foreign exchange spot market.

On the other hand, with respect to operations completed in more than one day and in t + 3 (Table B), there was a decline in gross and net values, and in the number of ope-

rations cleared: 48%, 48.3% and 48.8%, respectively. Similarly, the number of active participants went from 24 to 14.

In summary, the reduction in the SPL might have negatively affected the values of the variables analyzed. Although there are other factors that could also explain this situation, such as the behavior of the peso/dollar exchange rate (TRM: representative market rate),⁵ it was found that the correlation coefficient of the current TRM value and the gross value traded was -0.29 (Graph A). This reinforces the likelihood that changes in the parameters of the clearing mechanisms explain the variations in the quantity and value of market operations.

Graph A
Behavior of the TRM and Forex Spot Market Transactions
(Peso/Dollar)



Source: CRCC. Calculations by Banco de la República.

Clearing and settlement has been done by the CRCC since December 2020. However, as of February 2021, the CRCC began to use the novation mechanism to carry out these processes. The SPL remained at USD 65 m. These two conditions were left unchanged until September 2021. When comparing the previous period, evaluated on the basis of performance between February and September 2021, it was found that gross values, net values and the number of operations in the case of operations with t + 0 compliance had increased by 4.2%, 6.2% and 13.3%, respectively. The number of participants declined by one.

On the other hand, operations with compliance from t + 1 to t + 3 showed an increase of 3.7% in net value and a decline of 11.2% in gross value and 11.8 % in the number of operations. The number of participants also declined by one.

5 The TRM is the weighted average of the buy and sell foreign exchange rate for transactions to exchange United States dollars for Colombian pesos, agreed by exchange market intermediaries for completion in both currencies on the same trading day. The TRM in effect for any day is calculated with the operations of the previous business day.

The results were as expected. Elimination of the restriction that implied the establishment of bilateral quotas between the parties to transactions produced an increase in the analyzed variables. Likewise, participants may have had incentives to clear and settle their trades with CRCC intervention due, for example, to a substantial change in the risk management model, from one based on individual collateral requirements to one that also contemplates tools for mutualizing losses and replenishing financial resources.

Finally, in October 2021, the CRCC made an adjustment in terms of the liquidity providers by reducing the concentration of the two main credit lines and, thus, increasing the SPL by USD 15 m to UDS 80 m. A look at the period between October and December 2021 shows operations with t + 0 compliance rose in gross value, net value and number of operations by 9.4%, 24.8% and 7.2%, respectively. The number of participants remained at 31.

Operations completed in more than one day increased in gross value, in net value and in the number of operations by 16.9%, 14.1% and 40.3%, in that order. The number of participants increased by one to fourteen.

Generally speaking, it was found that the values and the number of transactions cleared and settled in the peso/dollar spot market are sensitive to changes in the SPL and to intervention in transactions through the CRCC. On the one hand, declines or increases in the SPL could affect, in the same sense, the values and volumes of trades, with a greater impact on the clearing of trades settled in more than one day. On the other hand, interposition by the CRCC could have increased the values and quantity of transactions cleared and settled for those with same-day compliance. This increase could be explained by the change in the credit and liquidity risk management model, which went from a scheme based on the management of individual collateral to a more robust one that implies a security-ring structure and the management of delays and defaults in a transversal way for all the products handled by the CRCC. However, the number of active members in this market did not increase with the change in the risk management model nor with the increase in the SPL. CRCC interposition implied the elimination of bilateral quotas in negotiation; consequently, the participation of a greater number of entities was not unexpected.