European Securities and Markets Authority

Date: 22 June 2018
ESMA70-151-1149

OPINION

CCP Liquidity Risk Assessment under Article 44(1) of Commission Regulation (EU) No 648/2012

1 Legal basis

1. ESMA's competence to deliver an opinion to competent authorities is based on Article 29(1)(a) of Regulation (EC) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority)[1](ESMA Regulation).

2. Pursuant to Article 29(1)(a) of ESMA Regulation, ESMA shall provide opinions to competent authorities for the purpose of building a common Union supervisory culture and consistent supervisory practices, as well as ensuring uniform procedures and consistent approaches throughout the Union.

3. In accordance with Article 21(6) of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories[2] (EMIR), ESMA shall fulfil a coordination role between authorities competent for the supervision of central counterparties (CCP) and across the CCP colleges, established pursuant to Article 18 of EMIR, with a view to building a common supervisory culture and consistent supervisory practices, ensuring uniform procedures and consistent approaches, and strengthening consistency in supervisory outcomes.

2 Background

4. According to paragraph 1 of Article 44 of EMIR, *"A CCP shall at all times have access to adequate liquidity to perform its services and activities. To that end, it shall obtain the necessary credit lines or similar arrangements to cover its liquidity needs in case the financial resources at its disposal are not immediately available. A clearing member, parent undertaking or subsidiary of that clearing member together shall not provide more than 25% of the credit lines needed by the CCP.*"

5. Specifically, the same Article 44(1) of EMIR states that a CCP shall measure, on a daily basis, its potential liquidity needs. *"It shall take into account the liquidity risk*

[1] OJ L 331, 15.12.2010, p. 48
[2] OJ L 201, 27.7.2012, p.1

generated by the default of at least the two clearing members to which it has its largest exposures." (Liquidity risk 'Cover-2')

6. Moreover, Article 32(4 and 5) of the Commission Delegated Regulation 153/2013 ("the RTS"), supplementing Article 44 of EMIR on liquidity risk controls and stress testing, further specifies the sources of liquidity risk that CCPs should consider in their liquidity risk management framework and make numerous clear references to a CCP's relationships with liquidity providers and how these should be addressed in a CCP's assessment of liquidity risk.

7. According to Article 32(4) of the RTS, *"A CCP shall assess the liquidity risk it faces including where the CCP or its clearing members cannot settle their payment obligations when due as part of the clearing or settlement process, taking also into account the investment activity of the CCP. The risk management framework shall address the liquidity needs stemming from the CCP's relationships with any entity towards which the CCP has a liquidity exposure including:*
   - *(a) settlement banks;*
   - *(b) payment systems;*
   - *(c) securities settlement system;*
   - *(d) nostro agents;*
   - *(e) custodian banks;*
   - *(f) liquidity providers;*
   - *(g) interoperable CCPs;*
   - *(h) service providers."*

8. Article 32(5) of the RTS adds that *"A CCP shall take into account any interdependencies across the entities listed in paragraph 4 and multiple relationships that an entity listed in paragraph 4 may have with a CCP in its liquidity risk management framework."*

9. Additionally, according to Article 51(3) of the RTS on stress testing procedure, "A CCP shall also consider other forms of appropriate stress testing scenarios including, but not limited to, the technical or financial failure of its settlement banks, nostro agents, custodian banks, liquidity providers, or interoperable CCPs."

10. Lastly, Article 54(3) of the RTS states that "The stress testing scenarios used in the stress testing of liquid financial resources shall (…) include all entities that might pose material liquidity risk to it."

11. Therefore, EMIR is clear that when performing their Cover-2 stress tests, CCPs need to assess the default of the two largest clearing members (and their affiliates) in all their capacities.

12. However, no further clarification is provided as to how CCPs should assess their liquidity risk when liquidity providers are not clearing members. Article 44(1) of EMIR only refers to the clearing members when it comes to defining liquidity risk 'Cover-2'.

13. This opinion aims at clarifying:

    (a) The assessment of the Liquidity Risk when a clearing member also acts as a liquidity provider;

    (b) The assessment of the Liquidity Risk when a liquidity provider is not a clearing member.

14. ESMA is of the view that a common approach at EU level on the application of Article 44 of EMIR would promote the convergence of supervisory practices on CCPs, including in respect of the assessment by national competent authorities of the CCPs liquidity risk management models. It would also foster a coherent application of the relevant Article 32(4) and (5) of the RTS on a matter that bears critical importance on general risk control practices.

3 Opinion

15. ESMA is of the opinion that, for the purpose of liquidity risk assessment:

    (a) According to Article 44(1) of EMIR and Article 32(4) and (5) of the RTS, when a clearing member fulfils not only a role of clearing member but also a role of an entity towards which the CCP has a liquidity exposure, this clearing member has multiple relationships vis-à-vis the CCP and each of these capacities must be taken into account.

    (b) Therefore, a CCP should test the failure of its clearing members in all their capacities. In doing so, the CCP should make assumptions relating to the availability and the enforceability of ex-ante back-up liquidity arrangements under stressed conditions.

    (c) Furthermore, when determining 'Cover-2', a CCP should test the default of every pair of clearing members acting in all their different capacities vis-à-vis the CCP and select the pair that corresponds to the largest exposure.

16. With respect to the compliance with Article 4(1) of the RTS (stating that "A *CCP shall have a sound framework for the comprehensive management of all material risks to which it is or may be exposed*"), ESMA is of the opinion that, while a liquidity need measurement should take into account the default of its top 2 clearing members in all their capacities as described under paragraph 15, the stress testing scenarios should, amongst others, consider all entities towards which the CCP has a liquidity exposure.

17. Beyond the liquidity needs arising from the liquidity risk generated by the default of at least the two clearing members to which the CCP has its largest exposures, the risk framework of the CCP shall also assess its liquidity position in each currency it clears under stress testing scenarios including the unavailability of its liquidity providers or of the liquidity tools at its disposal.

18. The liquidity tools to be considered could for instance include full market access (i.e. the ability to buy and/or sell securities immediately), same-day settlement (i.e. the ability to receive the cash from the liquidation on a same day basis), use of excess margin and access to the spot FX market (for CCPs that clear in more than a currency).

19. In doing so, the CCP should make assumptions relating to the availability and the enforceability of ex-ante back-up liquidity arrangements under stressed conditions.

20. The following paragraphs provide illustrations of some stress test scenarios that could be considered relevant for a CCP in order to comply with article 54(3) of the RTS. The below list of illustrations is not exhaustive and does not cover all possible liquidity stress test scenarios that could be relevant for a particular CCP.

21. For example, a CCP that would rely, for any currency that it clears, on commercial banks to provide settlement and custody services, would need to include in its risk framework the assessment of whether it could cover its liquidity needs in each currency if such banks become unavailable. Indeed, in such a case, the CCP would not be able to readily access the cash and securities held at those unavailable commercial banks and would not receive the expected margin and other payments settled through them.

22. Likewise, a CCP that would need access to the FX market to convert excess resources in one currency in order to cover for a shortfall in another, would need to assess the robustness of its FX arrangements in a stressed situation. Moreover, the CCP would have to ensure that such arrangements would be operational at the time in the day when this conversion would need to be made.