European Securities and Markets Authority

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PRESS RELEASE

ESMA's third EU-wide CCP stress test finds system resilient to shocks

The European Securities and Markets Authority (ESMA), the EU's securities markets regulator, has published the results of its third stress test exercise regarding Central Counterparties (CCPs) in the European Union (EU) which confirm the overall resilience of EU CCPs to common shocks and multiple defaults for credit, liquidity and concentration stress risks.

The credit stress test highlighted differences in resilience between CCPs under the selected market stress scenario, although no systemic risk has been identified. Similarly, the liquidity stress test showed EU CCPs to be resilient under the considered scenarios and did not reveal any systemic risk. Finally, the new concentration component added a new dimension to the exercise and highlighted the need for EU CCPs to accurately account for liquidation cost within their risk frameworks.

Additionally, the exercise was completed while the EU experienced a major and unprecedented crisis with the Covid-19 outbreak, which led to sharp and extreme market movements for instruments across most asset classes. ESMA, in coordination with the NCAs, closely monitored the impact on EU CCPs, which remained resilient through the crisis, despite the increased market volatility and operational risk. ESMA's stress scenarios were found to be overall of comparable severity with the most recent stress events.

Steven Maijoor, Chair, said:

> "ESMA's third stress test of CCPs in the EU has found that overall CCPs are capable of withstanding severe shocks under common shocks and simultaneous defaults. This resilience was also demonstrated during the unexpected and unprecedented impact of the COVID-19 pandemic on the global financial system. This provides reassurance given the key role these market infrastructures play.

“CCPs are at the heart of the financial system and the failure of one CCP has the potential to cause serious systemic risk across the EU. Therefore, testing whether CCPs can withstand extreme scenarios involving clearing member defaults and simultaneous market price shocks is an important supervisory tool in mitigating systemic risk.

“The CCP stress test remains a key supervisory tool for EU regulators in ensuring systemic resilience, financial stability and orderly markets. The importance of this tool was recognised in the EMIR review and has been extended to cover systemically important Tier 2 third-country CCPs in future.”

CCP stress test scenarios and outcomes

All 16 authorised CCPs are covered by the exercise, including the three UK CCPs. The exercise assesses credit, liquidity and includes a new concentration risk component, that aims at assessing the losses that may arise when liquidating concentrated positions.

Credit Stress Test

Two default scenarios were run, combined with the common market stress scenario, on two different reference dates, 21 December 2018 and 8 March 2019.

The first is a Cover-2 per CCP, where the default of two clearing member groups under common price shocks is assumed separately at each CCP. The second scenario is the EU-wide Cover-2 scenario, involving a default of the same two groups for all CCPs EU-wide, designed to assess the resilience of CCPs collectively to the market stress scenario.

The results show that:

- On 8 March 2019 one CCP exhibits a shortfall of prefunded resources which would have to be covered with additional non-prefunded resources; and
- On 21 December 2018, there is no shortfall of prefunded resources at any CCP.

Concentration Stress Test

Based on the sensitivity data provided by CCPs, the market impact (liquidation cost) was computed for all identified concentrated positions on one reference date (8 March 2019).

The EU-wide concentration analysis shows that concentrated positions represent a significant risk for EU CCPs. For most asset classes, concentrated position risk is clustered in one or 2 CCPs. At EU level, the largest concentration risk can be found in fixed income, with around 20bn EUR. Concentration in commodity derivatives and in the equity segment (securities and derivatives) is also significant, with around 9.5bn EUR of concentration risk.

The analysis found that concentration risk is factored in explicitly in a majority of CCPs, through dedicated margin add-ons. However, these add-ons are not always sufficient to cover the market impact, with a very large coverage gap on aggregate for commodity derivatives and to a lesser extent for equity products. In addition, a focus on individual clearing members coverage shows that concentration risk is not always covered properly at this level, as 4 CCPs have at least a clearing member whose market impact exceeds its total required margin. This highlights the importance for margin models to be conservative and accurate in capturing concentration risk.

Liquidity Stress Test

On the liquidity component two default scenarios have been run, a Cover 2 per CCP scenario, and an EU-wide Cover 2 scenario, on a single reference date (8 March 2019). Overall, the liquidity results show EU CCPs to be resilient under the implemented scenarios and tested assumptions, with only a few CCPs exhibiting a shortfall in at least one currency, requiring them to transform some of their resources available in one currency into another currency to meet their liabilities in a timely manner. The amounts remain negligible compared to the size of the FX market.

Next steps

As with previous exercises, the EU-wide stress test was not aimed at assessing the compliance of the CCPs with regulatory requirements, nor at identifying any potential deficiency of the stress testing methodology of individual CCPs. However, in line with the EMIR mandate, where the assessments expose shortcomings in the resilience of one or more CCPs, ESMA will issue the necessary recommendations.

Notes for editors

1. ESMA70-151-3186 3rd EU-wide CCP Stress Test

2. ESMA70-151-3190 3rd EU-Wide CCP Stress Test FAQ

3. The European Market Infrastructure Regulation (EMIR) requires ESMA to conduct EU-wide stress tests of EU-based CCPs on an annual basis. The exercise is conducted in cooperation with national competent authorities (NCAs), which supervise CCPs through supervisory colleges, and the ESRB. The stress test used reference data provided by CCPs which was validated and calculated by the NCAs based on the common scenarios and instructions.

4. The objectives of the EU-wide stress test exercise come directly from the legal mandate given to ESMA under EMIR. The objectives are to:

   - Assess the resilience of CCPs to adverse market developments,
   - Identify any potential shortcomings in the CCPs' resilience, and
   - Issue recommendations as appropriate.

5. ESMA is the European Union's securities markets regulator. Its mission is to enhance investor protection and promote stable and orderly financial markets.

   It achieves these objectives through four activities:

   - assessing risks to investors, markets and financial stability;
   - completing a single rulebook for EU financial markets;
   - promoting supervisory convergence; and
   - directly supervising specific financial entities.

6. ESMA achieves its mission within the European System of Financial Supervision (ESFS) through active cooperation with the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), the European Systemic Risk Board, and with national authorities with competencies in securities markets (NCAs).

Further information:

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