ESMA stress test of Central Counterparties finds clearing system resilient



PUBLISHED JUL 5, 2022
BY EUROPA

The report's key findings are:

CCPs have sufficient buffers to withstand adverse market developments in combination with the default of the two clearing members with the largest exposures;

Gaps are identified between the necessary and available buffers for concentration risks for some CCPs, particularly in commodity derivatives markets;

CCPs remained overall resilient despite increased market volatility in the wake of Russia's invasion of Ukraine;

For operational risk, differences in terms of risk sources, exposures and mitigation tools across CCPs are observed and need to be further assessed on an individual basis before issuing potential recommendations; and

Most of the analysed operational events stem from third-party services, whereas a number of critical third-party service providers have the potential to affect the critical functions of multiple CCPs in a correlated manner.

Klaus Löber, Chair of the CCP Supervisory Committee, said:

"ESMA's fourth stress test found that the European clearing market is resilient and capable of withstanding severe stress scenarios, although certain areas need further strengthening. CCPs' resilience was confirmed during the real-life market stress following Russia's invasion of Ukraine.

"CCPs are of critical importance to the stability of the financial system and the failure of one CCP has the potential to cause serious

systemic risk across the EU. Therefore, stress testing CCPs is a key supervisory tool to understand the clearing industry, identify issues relevant for financial stability and eventually mitigate systemic risk, contributing to ESMA's mission."

CCP stress test scenarios and outcomes

A total of 15 CCPs were covered by the exercise, including two UK CCPs qualifying as Tier 2 CCPs. The exercise assessed credit and concentration risk and included a new operational risk component that aimed to assess the resilience of CCPs to operational events and failures of third-party service providers.

Operational risk analysis

ESMA identified varying degrees of operational reliability for the CCPs included in the exercise and identified specific CCPs where further work should be conducted to understand the drivers of these differences, the root causes of the events, and the remediation actions taken.

ESMA also evaluated the exposure of CCPs to critical third-party service providers and the ability of CCPs to reduce risk through operational risk management tools. Through this process, ESMA identified differences across CCPs in their relative level of third-party risk as well as the critical third-party service providers with the highest systemic importance for the CCP sector. Further work is needed to analyse exposures to third-party service providers both at an individual CCP level, as well as system wide, to further strengthen operational resilience.

Credit Stress Test

Two default scenarios, combined with the common ESRB market stress scenario, were run on two different reference dates, 19 March (end of day) and 21 April 2021 (intraday snapshot).

For 19 March 2021, the impact due to concentration and specific wrong-way risk stemming from cleared positions was also included in the baseline scenario calculations. The first scenario concerned a Cover-2 default per CCP, where the default of two clearing member groups under common price shocks is assumed separately for each CCP. The second scenario was an All-CCPs Cover-2 default, involving

a default of the same two groups for all CCPs in the system, designed to assess the resilience of CCPs collectively to the market stress scenario. ESMA did not detect any major systemic risk concerns under the tested credit scenarios.

Concentration Stress Test

The European-wide concentration analysis performed on 19 March 2021 shows that concentrated positions represent a significant risk for CCPs. For most asset classes, concentrated position risk is clustered in one or two CCPs. The analysis found that concentration risk is factored in explicitly in a majority of CCPs, through dedicated margin add-ons.

Concentration modelled for commodity derivatives and the equity segment (securities and derivatives) is significant, with around 7bn EUR of concentration risk calculated for each asset class. There is a large coverage gap between the system-wide estimated market impact and margin add-ons for commodity derivatives and to a lesser extent for equity products. The concentration risk for emission allowances stands at 2.5bn EUR and is not adequately covered per the ESMA methodology.

Russia’s invasion of Ukraine

During the time of finalisation of the exercise, Russia’s invasion of Ukraine led to extreme market movements for instruments across the commodities and energy markets. ESMA concludes that the ESRB scenario is overall of greater or comparable severity for most asset classes, but of a lesser severity for some products, especially for power and gas derivatives. ESMA, in coordination with national competent authorities, also closely monitored the financial impacts that the invasion has had on CCPs. Overall, ESMA notes that CCPs remained resilient during the crisis, despite the extreme prices and increased market volatility.

Next steps

As with previous exercises, the ESMA stress test exercise for CCPs 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.

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Press release distributed by Wire Association on behalf of Europa, on Jul 5, 2022. For more information subscribe and follow us.

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