

ESMA launches third EU-wide CCP stress test exercise

For this third CCP stress test, ESMA has further developed its framework, adding a new component to the exercise on concentration risk, in addition to assessments on credit and liquidity risks. This new component will be used to assess the impact of liquidation costs for concentrated positions.

Steven Maijoor, ESMA Chair, said:

“CCPs are systemically important and ensuring their resilience is critical for the stability of the entire financial system. It is crucial to have an EU-wide picture to identify emerging systemic risks related to CCPs and ESMA’s stress test exercise is fundamental to identifying weaknesses and potential spill-over effects.

ESMA’s stress tests continue to evolve, we have built on the knowledge acquired in the first two exercises and have added a new component on concentration risk to ensure the exercise is fit for purpose.

The CCP stress test is an indispensable supervisory tool to contribute to systemic resilience, financial stability and orderly markets.”

Scope and components of ESMA’s CCP stress tests

ESMA, in cooperation with National Competent Authorities (NCAs) and the European Systemic Risk Board (ESRB), test the resilience of European CCPs by exposing them to different stress scenarios comprising of ‘*extreme but plausible market conditions*’. CCPs’ resilience will be assessed against a combination of multiple participant defaults and simultaneous market price shocks. The new stress test exercise has the following components:

- **Credit Stress:** Assess the sufficiency of CCPs’ resources to absorb losses under a combination of market price shocks and member default scenarios;
- **Liquidity Stress:** Assess the sufficiency of CCPs’ liquid resources under a combination of market price shocks, member/liquidity provider default scenarios and additional liquidity stress assumptions;
- **Concentration risk:** Assess the impact of liquidation costs derived from concentrated positions; and
- **Reverse Credit Stress:** Increase the number of defaulting entities and level of shocks to identify at which point resources are exhausted.

ESMA will also carry out additional analyses on the degree of inter-connectedness of CCPs, concentration of CCPs credit and liquidity exposures and a clearing member knock on analysis.

Market Stress Scenarios

The ESRB General Board has approved the adverse scenario and transmitted it

to ESMA. The European Central bank (ECB), in close collaboration with the ESRB and ESMA, has developed the narrative and calibrated the adverse scenario for the third CCP stress test, involving triggering one or more of the sources of systemic risk to the EU financial system, as identified by the ESRB.

The CCPs will be exposed to stress shocks that are defined for a large number of risk factors across all relevant asset classes. The shocks are derived using a methodology that considers the joint empirical distribution of historical observations of the risk factors deemed relevant to EU CCPs to produce a coherent scenario. The purpose of the stress test is not to assess the compliance of CCPs to the minimum regulatory requirements but assess their resilience to macro-economic scenarios that can have an EU-wide impact.

CCPs Involved and Timeline

The new exercise will cover the 16 CCPs authorised in the EU. Concerning the three UK CCPs (LCH Ltd, ICE Clear Europe Ltd and LME Clear Ltd), ESMA will include them within its exercise unless there is a no-deal Brexit. ESMA will shortly launch a data request to the CCPs.

Once received, the submitted data will first be validated by the NCAs and ESMA. This will be followed by the analysis and computation of the stress test results. The publication of the final report and results is scheduled to take place in Q2 2020.