

RECOMMENDATIONS OF THE EUROPEAN SYSTEMIC RISK BOARD ON LIQUIDITY RISKS ARISING FROM MARGIN CALLS REQUESTED BY CENTRAL COUNTERPARTIES (CCPs), THEIR CLEARING MEMBERS AND COUNTERPARTIES OF CONTRACTS NOT CLEARED BY A CCP

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On 20 July 2020, the Official Journal of the European Union published a series of Recommendations of the European Systemic Risk Board (ESRB) addressed to competent authorities of different financial institutions. These recommendations are aimed at reducing liquidity risk arising from margin calls.

The financial market turmoil caused by the Coronavirus outbreak triggered sharp declines in asset prices and higher volatility during the months of March and April of this year. As a result, market participants were subject to significant margin calls, both in respect of their positions cleared by central counterparties as well as their bilateral portfolios. The ESRB has assessed the potential negative impact on the liquidity management of financial and non-financial institutions and considered it relevant to issue these recommendations in order to avoid potential risks to financial stability arising from the need of participants to address increasing requests for funds in a short period of time, particularly bearing in mind the high degree of concentration and interconnection existing in financial markets.

Two of the recommendations proposed by the ESRB are aimed at ensuring that sudden and significant (hence procyclical) changes and cliff effects relating to initial margins and collateral are limited:

- by CCPs vis-à-vis their clearing members;
- by clearing members vis-à-vis their clients, and
- in the bilateral sphere, where they result from the mechanical reliance on credit ratings, and possibly, from procyclical internal credit scoring methodologies.

Liquidity planning should be predictable and manageable to the extent possible by limiting unexpected and significant margin calls. Providing reasonable and enforceable notice periods for any changes in margins and haircuts could ensure that market participants adapt to these changes in an orderly way.

Another recommendation is aimed at ensuring that CCPs fully incorporate in their liquidity stress testing any events that could lead to them experiencing liquidity shortfalls, with a view to incentivising them to improve their management of their reliance on liquidity service providers. This will improve overall market resilience, given that there is a high degree of concentration and interconnection among CCPs and their liquidity service providers, and that prudent liquidity management at individual CCP level would enhance risk management from a systemic and macroprudential perspective.

Finally, a specific recommendation has been included which is aimed at ensuring that CCPs, while maintaining their financial resilience, limit the asymmetry in the payment of variation margins collected intraday, and that margin frameworks and schedules are designed so as to be predictable and avoid excessive liquidity constraints for clearing members that could lead to default events.

The CNMV shares the ESRB's concern about the potential impact that the sudden application of these margin calls could have on market participants. Therefore, please be advised that the CNMV will take into consideration the ESRB's Recommendations on liquidity risks arising from margin calls in its supervisory activities relating to central counterparties, as well as with regard to the exchange of margins between financial and non-financial counterparties defined in Article 2(8) and (9) EMIR, in derivatives contracts not cleared by CCPs and in their activities as clearing members on behalf of clients.