

Follow-up Report

Global CCP fire drill 2023 – Main outcomes



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1 Executive Summary

Reasons for publication

The European Securities and Markets Authority (ESMA) is publishing this report to share the main outcomes of the global CCP fire drill that took place during the week starting 13 November 2023. The exercise involved over 30 global central counterparties (CCPs) simultaneously running a simulation of their default management processes, including the majority of EU CCPs. It was jointly coordinated by ESMA, EU and non-EU authorities, and the CCP industry association.¹

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Global fire drills in which multiple CCPs simultaneously test their default management processes are a crucial element to ensure the readiness of CCPs, clearing members, clients, and other stakeholders, including regulators, for the default of a material clearing member. The fact that CCPs executed this test at the same time supported the identification of potential operational bottlenecks in their procedures, such as the fact that non-defaulting clearing members of multiple CCPs may be solicited at the same time.

This report outlines the history and background of global CCP fire drills, the main outcomes of the fire-drill, and possible next steps. One of the main findings is that no major operational bottlenecks were identified. Nevertheless, further dialogue between CCPs, clearing members and their clients is encouraged to streamline CCP processes where possible.

Next Steps

ESMA will work with fellow regulators, CCPs and their stakeholders to ensure the key takeaways from the 2023 fire-drill will be taken into account for the continuous improvement of CCP default management practices in the future.

¹ ESMA would like to thank the CFTC, the Bank of England and CCP Global for their contributions to this report.

2 Background and objectives

1. On 13 November 2023, the largest global CCP fire drill to date took place. A total of 31 CCPs, 23 regulators, and dozens of clearing members and their clients took part in the simultaneous simulation of a default of a hypothetical major clearing member named A.C.M.E – A Clearing Member Everywhere. Participating CCPs conducted their default simulations under a high-level common narrative: A.C.M.E was assumed to be one of their five largest clearing members.
2. Global fire drills in which multiple CCPs simultaneously test their default management processes are a crucial element to ensure the readiness of CCPs, clearing members, clients, and other stakeholders, including regulators, for the default of a material clearing member. This is particularly true because the actual default of a large clearing member would typically involve multiple CCPs at the same time with non-defaulting clearing members and their clients needing to provide bids and personnel to those CCPs simultaneously.
3. The objectives of fire drills typically include the sharing of default management best practices among CCPs, identifying potential areas of follow-on work and providing insights for regulators. The simultaneous nature of and the broad participation to global multi-CCP fire drills also allow for the identification of potential bottlenecks which may not be uncovered in single-CCP default drills.
4. Moreover, these exercises are important from a financial stability perspective as the default of a material clearing member is an event that is likely to cause stress on the broader financial system. The importance of testing and reviewing CCP default procedures has also been recognised in global standards and regulations like the Principles for Financial Market Infrastructures (PFMI) and the European Market Infrastructure Regulation (EMIR)².

3 The 2023 fire drill built on previous exercises

5. The first global CCP fire drills coordinated by a group of regulators took place in 2016. Initially they were organised by the Bank of England, the Deutsche Bundesbank and the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and later also the Commodity Futures Trading Commission.³ Several exercises have been organised since 2016 with an increasing number of participants and regulators and varying scopes. Global standard

² EMIR (Article 48.1) requires CCPs to perform such fire drills on an annual basis and PFMI Principle 13.4 states that a CCP should involve its clearing members and other stakeholders in such an exercise as well.

³ See D. Bailey: 'Default management by central counterparties: the importance of preparation – introductory remarks to the CFTC's Market Risk Advisory Committee'.

setters have been covering this topic⁴ as well with the Committee on Payments and Market Infrastructures (CPMI) and the International Organisation of Securities Commissions (IOSCO) publishing a report in 2020 outlining issues for consideration regarding CCP default management auctions. A follow-up report was published in February 2023.⁵

6. While global exercises to test CCP default management preparations and procedures have been taking place for some time, the 2023 CCP Global International Default Simulation (2023 CIDS) exercise was by far the largest of its kind to date. The fire drill was jointly organised by regulators and the industry (represented by the Global Association of Central Counterparties - CCP Global), also attesting to the broad industry commitment to regularly perform such exercises.
7. The 2023 exercise was the first one in which ESMA actively participated through the preparation and coordination of the fire drill together with other regulators around the world. Throughout the exercise ESMA has acted as a relay of information and a facilitator for EU-CCPs and their respective regulators. In addition, ESMA has also tested its own crisis management procedure for the CCP Supervisory Committee. As part of this dedicated exercise, ESMA collected information using a harmonised template to create a comprehensive overview of the impact of the hypothetical A Clearing Member Everywhere default across all participating EU-CCPs. Further work will be performed to streamline this template to make it more user friendly and potentially applicable for all CCPs.

4 Main outcomes of the 2023 fire drill

8. As a follow-up to the 2023 CIDS Exercise, clearing members and their clients provided feedback through questionnaires, which was discussed at recent industry events in Madrid and during a workshop organised by the CPMI-IOSCO Policy Standing Group.
9. First, the most important outcome is that no major bottlenecks were identified even though a number of areas for improvements were identified. While a fire drill is only a simulation of a real crisis event, this shows that the industry is actively preparing to deal with major default management processes. Overall, participants to the exercise and the authorities agreed on the added value of global fire drills and were keen for similar exercises to take place in the future. Respondents also did indicate that the exercise would benefit from further strengthening the realism of fire drills, for example, through organising client porting simulation exercises in future fire drills.

⁴ CPMI-IOSCO, 'Central counterparty default management auctions – Issues for consideration', June 2020 (<https://www.bis.org/cpmi/publ/d192.pdf>).

⁵ CPMI-IOSCO, 'CPMI-IOSCO stocktake of industry progress on auctions', February 2023, (<https://www.iosco.org/news/pdf/IOSCONEWS681.pdf>).

10. Second, clearing members and their clients indicated that, in general, they were able to cope with the default of a material clearing member at multiple CCPs. However, some of them also indicated the need to prioritise some auctions over others due to resource constraints, which led to mandatory auctions being prioritised, potentially resulting in less bids in non-mandatory auctions.
11. Third, a large number of respondents noted standardisation and automation as ways to reduce operational risk in CCP default management processes. For example, some respondents indicated the use of default-management portals (instead of email communication). Portals and other tools could reduce operational risk if the tools used are reliable, user-friendly and support market practices. Regarding file formats, clearing members and their clients stated that the CCP processes would benefit from the use of market conventions and references to external data providers in auction files in addition to internal CCP references. Other areas for standardisation across CCPs that came out of the feedback include bidding formats and conventions, terminology, format, and communication methods of CCP announcements, and timelines of CCP default management processes.
12. Fourth, specifically regarding the hedging and auction process, some respondents noted the need for careful consideration of the level of hedging and the size and nature of the auction portfolios as ways to reduce the risk level of the portfolio and improve auction results. The possibility for CCPs to provide end of day or intraday pricing of auction portfolios to bidders as a control against erroneous pricing was also mentioned. Clearing members and their clients also noted the need for orderly execution of the auction within a short bidding window with “firm” prices and immediate confirmation of both winners and losers. The need for timely communication on timelines of auction processes by CCPs and ensuring that the liquidation of the portfolio is performed during market opening hours was also mentioned as a point for improvement.
13. Finally, in terms of other good practices, respondents noted the importance of CCPs having comprehensive handbooks, reference guides and documentation on their default management processes and tools. In addition, providing adequate walk-throughs, trainings and dry runs are considered a best practice. Another good practice is performing post-mortem exercises to understand the performance of all parties involved and identify lessons learned.

5 Next steps

14. Another exercise is intended to take place in 2025 (CIDS 2025) with the objective to, among others, expand the participation scope, for example with emerging markets CCPs. The key takeaways from the 2023 CIDS Exercise show significant overlap with the points identified by CPMI-IOSCO in its 2020 report and the subsequent stocktaking exercise, which

indicates further work can be performed by the industry on CCP default management practices.

15. One of these key takeaways is that while some aspects of CCP default management processes have been set up in a way that is optimal for a certain CCP, this may not always be the optimal solution for the market as a whole. Several respondents that participated in the fire drills of a number of CCPs indicated that navigating between the different processes of CCPs has its challenges. While ESMA is aware that creating common standards across CCPs is demanding, further dialogue between CCPs, clearing members and their clients is encouraged to further streamline CCP processes where possible.
16. Another key takeaway is the absence of major operational bottlenecks. It is especially worth noting that CCPs were positive on the functioning and resourcing of default management groups using seconded traders to assist in the CCP default management process. ESMA looks forward to work with fellow regulators, CCPs and their stakeholders on the continuous improvement of CCP default management practices in the future.