
TO : Regulated Entities

- i. Cyprus Investment Firms ('CIFs')**
- ii. Credit Institutions¹**
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- iv. UCITS and their Management Companies ('UCITS' / 'UCITS MC')**
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FROM : Cyprus Securities and Exchange Commission

DATE : 6 November 2020

CIRCULAR No : C414

SUBJECT : Recommendation 2020/6 of the European Systemic Risk Board (ESRB) on liquidity risks arising from margin calls (the 'Recommendation ESRB/2020/06')

The Cyprus Securities and Exchange Commission (the 'CySEC') wishes, with this circular, to inform the Regulated Entities that the ESRB issued on 25 May 2020 the [Recommendation 2020/06](#) on liquidity risks arising from margin calls. More specifically:

1. Recommendations A and D are aimed at ensuring that sudden and significant (hence procyclical) changes and cliff effects relating to initial margins (including add-on margins) and collateral are limited: (i) by CCPs vis-à-vis their clearing members; (ii) by clearing members vis-à-vis their clients; and (iii) 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 the margin and haircut protocols could ensure that market participants adapt in an orderly fashion.
2. Recommendation B is aimed at ensuring that CCPs capture comprehensively in their liquidity stress testing any events that could lead to them experiencing a liquidity

¹ Credit institutions as defined in article 2 of the Business of Credit Institutions Laws of 1997 to 2017 (Law No. 66(I)/1997), which they are allowed to provide/perform investment services/activities.

shortfall, with a view to incentivising them to improve their management of their reliance on liquidity service providers. This will improve the overall market resilience, given that there is a large degree of concentration and interconnection among CCPs and their liquidity service providers, and that prudent liquidity management at individual CCP level in this regard would enhance risk management from a systemic and macroprudential, perspective.

3. Recommendation C is aimed at ensuring that CCPs, while maintaining their financial resilience, limit the asymmetry in the payment of variation margins collected intraday – and that they design their margin frameworks and schedules so as to be predictable and avoid excessive liquidity constraints for clearing members that could lead to default events.
4. The ESRB considered it necessary to issue a recommendation by acknowledging the benefits in terms of liquidity savings for the whole financial system related to the multilateral netting benefit provided by central clearing; the ESRB also appreciates the systemic benefit of central clearing as a critical means to reinforce financial stability by ensuring and developing sound risk management practices in terms of credit and liquidity risk.

CySEC, adopts Recommendation ESRB/2020/6 by incorporating its recommendations into its supervisory practises. Regulated Entities are urged to take the necessary action in order to ensure their compliance with the above requirements.

Yours sincerely

Demetra Kalogerou
Chairman, Cyprus Securities and Exchange Commission