

# FMI STANDARD 7: LIQUIDITY RISK

FS7



## DOCUMENT VERSION HISTORY

1 March 2024	First issue date
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## INTRODUCTION

### Application

- i. This standard applies to every operator of a designated FMI that was specified in its designation notice under section 29(2)(f) of the Financial Market Infrastructures Act 2021 (the **Act**) as falling within one or more of the following classes of designated FMIs:
  - (a) a pure payment system; or
  - (b) securities settlement system; or
  - (c) a central counterparty.

### Legal powers

- ii. Under section 8 of the Act the regulator is defined as the RBNZ and the FMA acting jointly (or the RBNZ acting on its own in relation to pure payment systems).
- iii. Section 12 of the Act provides the regulator's functions. These include regulating designated FMIs, dealing with designated FMIs that are distressed, and other functions under the Act.
- iv. Subject to certain statutory prerequisites, section 31 of the Act empowers the regulator to make standards for designated FMIs.
- v. Section 34 sets out the matters that standards may deal with or otherwise relate to. Section 34(1)(e)(iv) provides that a standard may deal with, or otherwise relate to, the management by operators of liquidity risk.

### Interpretation

- vi. Words and phrases used in this standard have the same meaning as in the Act.
- vii. **Complex central counterparty activities** means central counterparty activities that have a more complex risk profile, including activities such as clearing financial instruments that are characterised by discrete jump-to-default price changes, or that are highly correlated with potential participant defaults.
- viii. A **deferred net settlement mechanism** means a settlement mechanism which settles on a net basis at the end of a predefined settlement cycle.
- ix. **Margin** means collateral that is collected to protect against current or potential future exposures resulting from market price changes or in the event of a counterparty default.
- x. **Nostro agent** means a bank or other financial institution in a jurisdiction other than the one the FMI operates in holding an account on behalf of an operator that is denominated in the currency of that other jurisdiction and used for the purposes of settlement.

- xi. **Simple central counterparty activities** means central counterparty activities that are not complex central counterparty activities.

## Commencement

- xii. This standard comes into force on [1 March 2024].

## REQUIREMENTS

- 1) An operator must measure, monitor, and manage the FMI's liquidity risk. An operator must ensure there are sufficient liquid resources available in all relevant currencies to effect same day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios.
- 2) An operator's qualifying liquid resources for the purposes of clause (1) include the following liquid resources:
  - a) cash at the central bank of issue and at creditworthy commercial banks; and
  - b) committed lines of credit; and
  - c) committed foreign exchange swaps; and
  - d) repos; and
  - e) highly marketable collateral held in custody and investments that are readily available and convertible into cash with prearranged and highly reliable funding arrangements, even in extreme but reasonably foreseeable market conditions; and
  - f) access to routine credit at a central bank of issue to the extent that the relevant FMI has collateral that is eligible for pledging to (or for conducting other appropriate forms of transactions with) the central bank.
- 3) Further to requirements in clause (1), an operator must:
  - a) not assume the availability of emergency central bank credit as a part of the FMI's liquidity plan; and
  - b) have a robust framework to manage liquidity risks for the FMI from its participants, settlement banks, nostro agents, custodian, liquidity providers, and other entities; and
  - c) have effective operational and analytical tools to identify, measure, and monitor the FMI's settlement and funding flows on an ongoing and timely basis, including its use of intraday liquidity.

## Liquidity providers

- 4) Further to the requirements in clauses (1) and (3), an operator must obtain a high degree of confidence, through rigorous due diligence, that each provider of the FMI's minimum required qualifying liquid resources, whether a participant of the FMI or an external party, has sufficient information to understand and to manage the provider's associated liquidity risks, and that the provider has the capacity to perform its commitment as required. If relevant to assessing a provider's performance reliability with respect to a particular

currency, a provider's potential access to credit from the central bank of issue may be taken into account.

- 5) An operator must annually test the procedures for accessing liquid resources from the provider.

### **Stress testing**

- 6) Further to the requirements in clause (1), an operator must determine the amount of, and annually test the sufficiency of, the FMI's liquid resources through rigorous stress testing. This includes that:

- a) an operator must have clear policies and procedures in place for it to report the results of its stress tests to the board of directors, and to use these results to evaluate the adequacy of, and then adjust, its liquidity risk management framework.
- b) in conducting stress testing, an operator must consider a wide range of relevant scenarios, including:
  - i) relevant peak historic price volatilities; and
  - ii) shifts in other market factors such as price determinants and yield curves; and
  - iii) multiple defaults over various time horizons; and
  - iv) simultaneous pressures in funding and asset markets; and
  - v) a spectrum of forward-looking stress scenarios in a variety of extreme but reasonably foreseeable market conditions; and
- c) scenarios must also take into account the design and operation of the FMI, including all entities that might pose material liquidity risks to the FMI, and where reasonable, cover a multiday period; and
- d) an operator must appropriately document its supporting rationale for, and have appropriate governance arrangements relating to, the amount and form of total liquid resources that the FMI maintains.

### **Procedures for settlement following participant default**

- 7) Further to the requirements in clause (1)), an operator must establish explicit rules and have clear policies and procedures that enable the FMI to effect same-day and, where reasonable, intraday and multiday settlement of payment obligations on time, following any individual or combined default among its participants. These rules and procedures must:
  - a) address unforeseen and potentially uncovered liquidity shortfalls and must aim to avoid unwinding, revoking, or delaying the same-day settlement of payment obligations; and
  - b) indicate the process to replenish any liquidity resources an operator may employ during a stress event, so that the FMI can continue to operate in a safe manner.

## Pure payment systems and securities settlement systems

- 8) An operator of a pure payment system or securities settlement system, including one employing a deferred net settlement mechanism, must maintain sufficient liquid resources for the FMI in all relevant currencies to effect same-day settlement, and where appropriate intraday or multiday settlement, of payment obligations with a high degree of confidence under a wide range of potential stress scenarios.
- 9) The scenarios in clause (8) must include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate payment obligation in extreme but reasonably foreseeable market conditions.

## Central counterparties

- 10) Further to the requirements in clause (1), an operator of a central counterparty must maintain sufficient liquid resources in all relevant currencies for the central counterparty to:
  - a) settle securities-related payments; and
  - b) make required variation margin payments as per Standard 6; and
  - c) meet other payment obligations on time with a high degree of confidence under a wide range of potential stress scenarios that must include, but not be limited to:
    - i) where the operator is an operator of an FMI engaging in simple central counterparty activities, and the FMI is not systemically important in multiple jurisdictions (including New Zealand), the default of the largest participant and its affiliates that would generate the largest aggregate payment obligation to the FMI in extreme, but reasonably foreseeable, market conditions; or
    - ii) where the operator is an operator of an FMI engaging in complex central counterparty activities, or where the FMI is systemically important in multiple jurisdictions (including New Zealand), the default of the two largest participants and their affiliates that would generate the largest aggregate payment obligation to the FMI in extreme, but reasonably foreseeable, market conditions.

*(See Guidance for Standard 7: 'Liquidity', in Guidance for the FMI Standards for more detail).*