# Sovereign Crises and Bank Financing: Evidence from the European Repo Market



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## Abstract

How do crises affect Central clearing Counterparties (CCPs)? We focus on CCPs that clear and guarantee a large and safe segment of the repo market during the Eurozone sovereign debt crisis. We start by developing a simple framework to infer CCP stress, which can be measured through the sensitivity of repo rates to sovereign CDS spreads. Such sensitivity jointly captures three effects: (1) the effectiveness of the haircut policy, (2) CCP member default risk (conditional on sovereign default) and (3) CCP default risk (conditional on both sovereign and CCP member default). The data show that, during the sovereign debt crisis of 2011, repo rates strongly respond to movements in sovereign risk, in particular for GIIPS countries, indicating significant CCP stress. Our model suggests that repo investors behaved as if the conditional probability of CCP default was very large.

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