EACH response to ESMA Consultation 'Review of RTS No 153/2013 with respect to procyclicality of margin'

March 2022

1. Introduction

The European Association of CCP Clearing Houses (EACH) represents the interests of Central Counterparties (CCPs) in Europe since 1992. CCPs are financial market infrastructures that significantly contribute to safer, more efficient and transparent global financial markets. EACH currently has 18 members from 14 different European countries. EACH is registered in the European Union Transparency Register with number 36897011311-96.

EACH appreciates the opportunity to provide feedback to the ESMA consultation 'Review of RTS No 153/2013 with respect to procyclicality of margin'[1] (hereinafter "The consultation" or "The consultation paper").

As summary of the ideas included in this response can be found below:

- **Timing of the consultation** - EACH respectfully questions whether this is the right moment to consult on Anti-procyclicality (APC) at European level, given that the EMIR APC measures appear to have worked well during recent market stresses, the work at international level on this subject is still ongoing and the ongoing market volatility resulting from the geopolitical events in Europe is making CCPs focus more than ever on their crucial risk management functions.
- **Different reactions of margin models to COVID-19 market stress** - We believe that CCPs' margin models may indeed react differently to market stresses because risk appetites vary depending on the CCP and thus the APC policies and procedures will vary by CCP. Different CCPs require the flexibility to adapt their margins to their respective situations. EACH would caution against any trend for CCPs to apply a single or centralised margin model, which a full harmonisation of risk policies and procedures leads to.
- **Regular assessment and reviews of APC measures, Quantitative metrics to measure procyclicality and Application of APC margin measures to all material risk factors** (**Consultation Sections 4.1, 4.2 and 4.3**) – While EACH general agrees with the proposals made by ESMA in these sections, we have made some suggestions to remove what we understand is unnecessary granularity in the draft RTS.
- **APC EMIR tool #1 - Margin buffer under Article 28(1)(a) of the RTS (Consultation Section 5.1)** – EACH generally agree with the proposals made by ESMA. We however question the need for CCPs to justify/regularly check the appropriateness of their choice to assess if a higher (more conservative) buffer would be needed.
- **APC EMIR tool #2 - 25 % weight to stressed observations under Article 28(1)(b) of the RTS – Consultation section 5.2** – EACH disagrees with the requirement for CCPs to have to consider potential future scenarios identified under Article 30(2)(b) as CCPs consider this unjustified and unnecessary additional work. We would also suggest aligning the review process with the one included in EMIR Article 31 to avoid an unnecessarily burdensome too frequent revision. We would also stress the potential for some of the changes to indirectly lead to higher confidence intervals and therefore

[1] https://www.esma.europa.eu/sites/default/files/esma91-372-1975_consultation_paper_on_review_of_emir_rts_on_apc_margin_measures.pdf

suggest ESMA to reconsider these. We would finally call for ESMA to consider an implementation period for this RTS, given that the new approach suggested by ESMA may differ significantly from CCPs' current practices and the number of changes suggested by ESMA in the draft RTS would trigger several governance procedures such as model validation and approval of risk committees

- **APC EMIR tool #3 - Margin floor under Article 28(1)(c) of the RTS (Consultation section 5.3)** - We respectfully consider that there are cases where ESMA's proposal to modify Article 28(1)(c) RTS would present difficulties for CCPs in practice. We consider that the proposal is very prescriptive in terms of the three simultaneous conditions to be met: (1) 10 years; (2) stress events and (3) no scaling. We also consider that the proposed wording does not recognise the CCP internal standards and controls around APC, which would flag if indeed more belt and braces would be required for a 10-years lookback model.

3. General feedback

In addition to answering ESMA's consultation questions which we do in the subsequent sections of this response, EACH would like to provide some general feedback on the consultation:

- **Timing of the consultation** - EACH welcomes the opportunity to discuss APC measures, this being a crucial subject in the interest of all financial market participants and useful tool for CCPs to address margin volatility. However, regarding the overall timing of this consultation, EACH questions whether this is the right moment to consult on APC at European level, given that the EMIR APC measures appear to have worked well[2], the work at international level on this subject is still ongoing as noted in the ESMA consultation on paragraphs 24 onwards and the ongoing market volatility resulting from the geopolitical events in Europe is making CCPs focus more than ever on their crucial risk management functions. EACH understands and welcomes ESMA's objective of not '*adding new requirements on EU CCPs which could lead to inconsistent or potentially duplicative rules should new standards be developed at the international level*' as per paragraph 26 of the consultation paper. However, EACH believes that a timeline that better considers the ongoing international work would promote a more fruitful review of APC measures and would also avoid the risk of a disconnect between European and International approaches.

- **Different reactions of margin models to COVID-19 market stress** - EACH notes that paragraph 14 of the consultation paper as well as recital 5 of the draft RTS refer to CCP margin models having reacted differently to the COVID-19 market stress, with some '*models performing in a more procyclical manner than others*'.

  We believe that CCPs' margin models may indeed react differently to market stresses because risk appetites vary depending on the CCP and thus the APC policies and procedures will vary by CCP. Different CCPs require the flexibility to adapt their margins to their respective situations. This extends to intra-group variability, with some CCPs being part of the same group but serving different markets and thereby having different margin requirements.

  While ESMA has informally referred to the views of some stakeholders stressing that 'similar' CCP margin models reacted 'differently' to the COVID-19 market stress[3], we note that some of the evidence provided is at a relatively high level. First, we would like to highlight that the comparison of initial margin (IM) charges per unit of risk is run for different CCPs and different products. Furthermore, it is not clear how in those papers 'similarity' of margin models is defined neither how to assess 'similarity' of the models' reaction. EACH Members do not see the evidence in the cleared space to support the issue being raised here. Furthermore, a major buy-side firm noted in the

[2] www.eachccp.eu%2Fwp-content%2Fuploads%2F2021%2F06%2FEACH-Paper-CCP-resilience-during-the-COVID-19-Market-Stress-June-2021.pdf

[3] e.g. https://www.fia.org/sites/default/files/2020-10/FIA_WP_Procyclicality_CCP%20Margin%20Requirements.pdf

ESMA open hearing on APC on March 17th 2022 that the impact of the COVID-19 market stress was smaller in Europe than in other jurisdictions thanks to the existing EMIR APC measures. We also note that margin model reaction takes into account both margin and APC, so it would be questionable to conclude that any model reaction may be due to issues with the APC component. As such, EACH would welcome a more detailed explanation of ESMA's reasoning behind this statement, given their wider view of the markets. Additionally, we would welcome ESMA's explanation as to how their solution proposed in the form of this draft RTS will solve this apparent issue.

EACH would caution against any trend for CCPs to apply a single or centralised margin model, which a full harmonisation of risk policies and procedures leads to. This is counterproductive to good risk management if we consider the above point that CCPs require flexibility due to varying risk appetites.

Based on the above, we suggest ESMA to delete the references to CCPs margin models performing differently in recital 5 of the draft RTS or alternatively clarifying what the exact issue is in case the draft text in the consultation requires additional explanation.

2. EACH answers to ESMA questions listed in Annex 1

Regular assessment and reviews of APC measures – Consultation Section 4.1

Question 1: Do you agree that CCPs should be able to explain and justify their APC tool choices?

EACH Members agree that CCPs should be able to explain and justify their APC tool choices. We would however strongly suggest that the analysis is limited to the tool(s) chosen and does not lead to some analysis of the three tools when only one or two are considered. In this line we would suggest clarifying the wording of the RTS accordingly, and in particular the following two paragraphs which could potentially lead to confusion:

- Article 28(a)(d) "the frequency at which it conducts the assessment with respect to the choice between the options mitigating the potential procyclical…" could read as if the CCP needs to justify the choice of APC tools relatively to the other two options.
- Article 28(a)(g) "the public disclosure of information on the functioning and performance of the CCP's choice between the options mitigating the potential procyclical effects of its margin revisions as provided for in Article 28(1)."

Question 2: Do you agree that CCPs should define their own APC thresholds for margin changes based on their risk appetite/tolerance? Should the RTS explicitly require that CCPs seek the advice of the risk committee, when setting or reviewing its APC policies, including defining the risk appetite?

EACH Members agree that CCPs should define their own APC thresholds for margin changes based on their risk appetite/tolerance. We appreciate ESMA's flexibility and acknowledgement that it would be very difficult to determine a common threshold which could be applied coherently across products cleared, risk models and APC tools and that the CCP is best placed to determine internal targets to examine the adequacy of its APC policy based on its own risk-appetite, rather than by setting external thresholds.

We however question the inclusion of the reference to the risk appetite in the RTS Article 1(2)(b) and would rather refer to the APC thresholds set by the risk committees and Boards. We rather believe that CCPs have in place policies and procedures that define APC thresholds and its implementation. In case ESMA wants to make a higher-level reference than this one, we would suggest referring to risk 'tolerance' rather than risk 'appetite'.

Question 3: Do you agree with ESMA's proposal to draft a new Article 28a? What other requirements should ESMA consider introducing in relation to the CCP APC policies and procedures?

As per the above, EACH believes that the amendment to article 28 (a) of the draft RTS should be deleted.

While we agree with the intention of ESMA for CCPs to have APC policies and procedures that are reviewed at least on an annual basis, we consider that the RTS proposal is unnecessarily prescriptive. We would therefore suggest editing the RTS accordingly and deleting Article 28(a)(a).

Quantitative metrics to measure procyclicality – Consultation Section 4.2

Question 4: Do you agree with ESMA's proposed amendment to require CCPs to assess margins based on quantitative metrics in the context of procyclicality?

While EACH generally agrees with this proposed amendment to require CCPs to assess margins based on quantitative metrics in the context of procyclicality, we disagree with the requirement for considering metrics that assess the '*long-term stability of margins over time and their conservativeness*'. We consider that in the context of APC, considering the short-term impact would be enough and a requirement to consider long-term impact is overly burdensome and unnecessary.

Question 5: Do you agree with ESMA's proposal to introduce these three dimensions (i.e. stability, conservativeness and over-collateralisation)? Should these be mandatory or optional? How do these compare to the quantitative metrics that CCPs currently consider in practice??

EACH agrees that the proposed three dimensions capture important aspects to consider when assessing procyclicality. However, they are neither exhaustive nor uniquely related to the risk appetite of the CCP.

We also note that while the stability dimension is particularly related to the concept of APC, the concepts of conservativeness and over-collateralisation may be considered in other contexts such as the level of coverage of IM models, for which there is a minimum regulatory requirement, and for which CCPs have the ability to set them according to the CCP's internal risk appetite.

We would therefore kindly suggest that the RTS clarify these are optional rather than compulsory.

Question 6: Do you agree with ESMA's proposal to include in the RTS a requirement for CCPs which clear products whose price/yield can vary significantly to perform the assessment of the procyclicality of its margin model across different price/yield levels ?

EACH supports this proposal given Article 28 (a)(2) of the consultation's draft RTS notes that CCPs "shall consider" performing this assessment rather than obliging them to do so. An obligation would represent an unnecessary, granular and prescriptive requirement, as such details should be set in the CCPs internal policies and procedures, and also given that not all products may need such assessment.

Application of APC margin measures to all material risk factors – Consultation Section 4.3

Question 7: Do you agree with ESMA's proposal to introduce into the RTS the requirement on CCPs to calculate APC margin requirements at all material risk factors?

EACH is supportive of the proposal to introduce into the RTS the requirement for CCPs to calculate APC margin requirements for all material risk factors, as long it is up to the CCPs to define its material risk factors, which we understand is indeed the case due to the inclusion of the wording 'could include' in the draft RTS of amended Article 28 paragraph 2.

Question 8: Do you agree with ESMA's proposal to consider the impact that the risk factor change will have on the margin, including for products with non-linear dependence on risk factors?

See our answer to question 7.

Question 9: Do you agree with ESMA's proposal on how to apply the APC options for different risk factors?

See our answer to question 7.

Margin buffer under Article 28(1)(a) of the RTS – Consultation Section 5.1

Question 10: Do you agree with ESMA's proposal that CCPs using the APC tool under Article 28(1)(a) should develop policies and procedures detailing the use of the buffer and its replenishment as included in the draft RTS test? Are there other items that the procedures should consider in the RTS?

EACH agrees that CCPs using the APC tool under Article 28(1)(a) should develop policies and procedures describing the use of the buffer and its replenishment as included in the draft RTS.

This is already a best practice by CCPs in line with the ESMA APC Guidelines[4]. To more clearly emphasise the allowed discretion discussed in question 11, EACH suggests replacing 'should' with 'should consider' in the text after the first sentence of the amended article 28 (1)(a). We do not consider there being other items that the procedures should consider in the RTS.

Question 11: Do you agree that CCPs should set predefined thresholds but also be granted a degree of discretion when triggering the exhaustion of the margin buffer subject to appropriate governance arrangements?

EACH agrees that CCPs should retain a degree of discretion and understand the overall reasoning behind setting predefined thresholds.

Question 12: Do you agree with ESMA's proposal to set the minimum buffer to 25% while requiring CCPs to assess if a higher buffer would be needed and justify / regularly check the appropriateness of their choice?

EACH agrees with ESMA's proposal to set the minimum buffer to 25%. We however question the need for CCPs to justify / regularly check the appropriateness of their choice to assess if a higher (more conservative) buffer would be needed. When compared to the existing requirements under EMIR Articles 24 to 27, we believe that the proposed requirement is too prescriptive. As an example under EMIR Article 24(3) of the EMIR RTS 153/2013, CCPs are required to '*inform its competent authority and its clearing members on the criteria considered to determine the percentage applied to the calculation of the margins for each class of financial instruments*'. While we agree with a similar requirement for buffers higher than the minimum of 25%, we would question the need for a full and regular justification about the appropriateness of the CCP's choice, as this would lead to an even more conservative model in terms of risk management which we consider should not be subject to the related administrative burden. We would therefore suggest deleting such requirement from the RTS.

Question 13: Are there cases where ESMA's proposal to modify Article 28(1)(a) RTS would present difficulties for CCPs in practice?

Yes, as indicated in our response to Question 12, EACH questions the need for CCPs to justify/regularly check the appropriateness of their choice to assess if a higher (more conservatives) buffer would be needed. Under EMIR Article 24(3) of the EMIR RTS 153/2013, CCPs are required to '*inform its competent authority and its clearing members on the criteria considered to determine the percentage applied to the calculation of the margins for each class of financial instruments*'. While we agree with a similar requirement for buffers higher than the minimum of 25%, we would question the need for a full and regular justification about the appropriateness of the CCP's choice, as this would lead to an even more conservative model in terms of risk management which we consider should not be subject to the related administrative burden. We would therefore suggest deleting such requirement from the RTS.

[4] ESMA 15/04/2019 | ESMA70-151-1496

25 % weight to stressed observations under Article 28(1)(b) of the RTS – Consultation section 5.2

Question 14: Do you agree that CCPs should consider the extreme market movements from the historical stress scenarios identified under Article 30 of the RTS?

Yes, we agree that CCPs should consider the extreme market movements from the historical stress scenarios identified under Article 30 of the RTS.

Question 15: Do you agree with ESMA's proposal that CCPs should also consider including the extreme market movements from the potential future stress scenarios identified under Article 30(2)(b)?

CCPs generally consider that regarding potential future stress scenarios it would be more consistent to restrict the set of stress scenarios to historical ones and just overnight. In addition, theoretical scenarios are not easy to incorporate because they are subject to a methodology on their own. EACH disagrees with the requirement for CCPs to have to consider potential future scenarios identified under Article 30(2)(b) as CCPs consider this unjustified and unnecessary additional work. We of course agree that CCPs are not obliged to 'use' future scenarios and in addition respectfully reject the obligation to 'consider' them, given the unnecessary burden it represents.

We therefore suggest the removal of the amendment to article 28(1)(b) as per Article 1 (1)(a) of the DRAFT RTS amendment included in the ESMA consultation paper.

Question 16: Do you agree to require that CCPs ensure the set of extreme market movements includes an adequate number of extreme market movements for all margined products, including the ones that could expose it to the greatest financial risks?

While EACH Members agree with the requirement that CCPs ensure that the set of extreme market movements includes an adequate number of extreme market movements for those margined products that could expose it to the greatest financial risks, we kindly request clarification as to why the proposed text in paragraph b) of the draft RTS includes a requirement for considering all margined products as well as those that could expose it to the greatest financial risks, as we understand that the latter, and most relevant from our point of view are included in the former.

Our understanding is that a given extreme historical market movement could potentially be comprised in both the 'unadjusted' initial margin scenarios and the 'stress' initial margin scenarios. If a stress event has happened in the recent history that scenario could potentially be included both in the unadjusted margin and in the stress component; this would have potentially unwanted consequences of double counting

We would therefore suggest deleting the reference to all margined products in paragraph b) of the draft RTS while keeping the one to those margined products that could expose the CCP to the greatest financial risk.

Question 17: Do you agree with ESMA's proposal not to include a specific time restriction on when CCPs should add new stress observations in the set of extreme market movements used for the purpose of the APC tool, but instead add a provision to consider reviewing more frequently taking into account the procyclical effects from such revision?

Whilst this proposal gives CCPs flexibility with adding new stress observations during extreme market movements, a requirement for too frequent a revision of such an addition would unnecessarily increase the burden on CCPs.

We would rather suggest aligning the review process with the one included in Article 31 of the EMIR RTS 153/2013 and therefore replace the requirement in the draft RTS that states that '*The CCP shall consider reviewing the set of extreme market movements more frequently taking into account the procyclical effects from such revision.*' with a requirement for the review process to be governed by the normal procedure under Article 31 of the EMIR RTS 153/2013.

Question 18: Do you agree with ESMA's proposal that CCPs should calculate the stress margin using the same model and parameters in compliance with Articles 24, 26 and 27, except for the time horizon under Article 25?

EACH would also like to highlight that this proposed change effectively leads to the use of higher confidence intervals and we do not encourage a change with such a consequence.

We would also kindly request ESMA to clarify its proposals regarding the number of 'stress' initial margin scenarios, in particular with regard to 'unadjusted' initial margin scenarios. Given the proposal of employing the same parameters, including confidence level, its impact is relevant in terms of different number of tail events.

Applying the same model and parameters for the stressed margin as for the unadjusted margin could have unwanted effects as for example instability of the stress component (e.g. a risk model based on 2,500 scenarios (IM 10Y) will be expected to be more stable than if applied to 100 (stress) scenarios.

In a similar manner to Article 28(a) and the necessary discretion when the buffer should be exhausted (see question 11), EACH suggests replacing 'should' with 'should consider' in the text after the first sentence draft RTS article 28 (1)(b)(4).

Question 19: Do you agree that for the purpose of calculating the stress margin to be used for the calibration of the APC tool, CCPs should recompute the stress margin at least daily and shall avoid using scaling techniques that can affect the severity of observations or calculated stressed margin?

In the context of the APC tool (b) and weight to stress losses, the recommendation not to scale the stress scenario seems reasonable, even if prescriptive. However, scaling techniques might have been used when defining some of the scenarios within the requirements of EMIR Article 30.

We would kindly request ESMA to clarify that the recommendation to avoid scaling does not refer to scaling that might have been used at the point of defining a stress scenario; this would impact for example stress scenarios defined using scaling of historical event to define shocks plausible to present market levels.

Question 20: Do you agree with ESMA's proposal to include the provision to allow CCPs to temporarily increase the weight that is applied to the unadjusted margin and equally reduce the weight applied to the stress margin? Should there be a time limit on this provision?

No comments from EACH Members

Question 21: Are there cases where ESMA's proposal to modify Article 28(1)(b) RTS would present difficulties for CCPs in practice?

Given that the new approach suggested by ESMA may differ significantly from CCPs' current practices, EACH politely enquires whether an implementation period will be allowed by ESMA. The number of changes suggested by ESMA in the draft RTS would trigger several governance procedures such as model validation and approval of risk committees. In addition, all these changes may be subject to an EMIR Article 49 procedure and likely for across all EU-authorised and Tier-2 recognised CCPs at the same time, potentially creating a bottleneck of approvals. We would also therefore kindly ask ESMA to clarify whether the eventual changes derived from this new RTS will have to be subject to and EMIR Article 49 or could skip them given that the changes as triggered by an ESMA regulation.

Margin floor under Article 28(1)(c) of the RTS – Consultation section 5.3

Question 22: Do you agree with ESMA's proposal that the margin floor should include stress market movements in addition to the 10-year lookback period?

While EACH agrees with the general objective of ESMA's proposal, we believe that the requirement for the margin floor to include stress market movements '*in addition*' to the 10-year lookback period should be optional rather than compulsory, given that the 10-year lookback may already include stress observations (e.g. COVID-19 market stress or recent energy prices). We would therefore suggest adapting paragraph c) of the draft RTS accordingly.

Do you agree with the methodology used to identify these extreme market movements?

See our response to Question 14.

Question 23: Do you agree that the margin floor should be calculated in compliance with Articles 24, 26 and 27 of the RTS?

Yes, EACH agrees with ESMA's proposal.

Question 24: Do you agree that the margin floor should be recomputed at the same frequency than the baseline margin requirements?

Yes, EACH agrees with ESMA's proposal.

Question 25: Do you agree that, when calculating the margin floor, CCPs shall avoid using scaling techniques that can affect the severity of observations, extreme market movements or calculated floor margin?

It is unclear whether ESMA intends that a 10-year margin floor be in place even when the margin model uses a 10-year lookback, and in accordance with articles 24, 26 and 27. Currently RTS 28 (c) requires '*(c) ensuring that its margin requirements are not lower than those that would be calculated using volatility estimated over a 10 year historical lookback period*'; therefore an IM model using 10-year lookback is compliant with (c). The new proposed RTS 28 1(c) does not recognise the sufficiency of the 10-year lookback for an IM model where scaling observations is used. In case this is indeed ESMA's intention, we would not support this proposal.

Question 26: Are there cases where ESMA's proposal to modify Article 28(1)(c) RTS would present difficulties for CCPs in practice?

Yes, we consider that there are indeed cases where ESMA's proposal to modify Article 28(1)(c) RTS would present difficulties for CCPs in practice.

Firstly, we consider that the proposal is very prescriptive in terms of the three simultaneous conditions to be met: (1) 10 years; (2) stress events and (3) no scaling. We note that there will be models where the 10-years and scaling are used, with stress event in the 10-year lookback period and a scaling with anti-procyclicality features bult in. In light of the proposed wording of 28 (c), such model would now be required to have and additional floor in place.

Secondly, we respectfully consider that the proposed wording does not recognise the CCP internal standards and controls around APC, which would flag if indeed more belt and braces would be required for such a model.

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