



European Securities and  
Markets Authority

# Response Form to the Consultation Paper

**Review of RTS No 153/2013 with respect to procyclicality of margin**



## Responding to this paper

ESMA invites comments on all matters in this consultation paper and in particular on the specific questions summarised in Annex III. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **31 March 2022**.

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input - Consultations’.

### Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

1. Insert your responses to the questions in the Consultation Paper in the present response form.
2. Please do not remove tags of the type <ESMA\_QUESTION\_APC\_1>. Your response to each question has to be framed by the two tags corresponding to the question.
3. If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.
4. When you have drafted your response, name your response form according to the following convention: ESMA\_APC\_nameofrespondent\_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA\_APC\_ABCD\_RESPONSEFORM.
5. Upload the form containing your responses, in Word format, to ESMA’s website ([www.esma.europa.eu](http://www.esma.europa.eu) under the heading “Your input – Open consultations” → “Consultation on the review of RTS 153/2013 with respect to procyclicality of margin”).

## **Publication of responses**

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

## **Data protection**

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading [Legal Notice](#).

## **Who should read this paper?**

All interested stakeholders are invited to respond to this consultation. In particular, this paper may be specifically of interest for EU central counterparties, clearing members and clients of clearing members.

## General information about respondent

Name of the company / organisation	Deutsche Börse Group
Activity	Central Counterparty
Are you representing an association?	<input type="checkbox"/>
Country/Region	Germany

## Introduction

***Please make your introductory comments below, if any***

<ESMA\_COMMENT\_APC\_00>

Deutsche Börse Group (DBG), in particular its CCPs Eurex Clearing and European Commodity Clearing, appreciates the opportunity to provide feedback to the Consultation Paper on the Review of RTS No 153/2013 with respect to procyclicality of margin.

Eurex Clearing is an EMIR-authorized central counterparty (CCP) and provides clearing services for cash and derivatives markets in listed and over-the-counter (OTC) financial instruments. European Commodity Clearing (ECC) is an EMIR-authorized CCP and provides clearing services for spot and derivative commodity contracts.

While EU CCPs have proven their robust risk management during recent periods of high market volatility, model reactivity to market volatility renewed attention on APC measures. In context of industry discussions around procyclicality it is important from a general perspective to understand the drivers of increases in margin requirements at CCPs, which can be broken down into market move driven effects, margin parameter increase effects and portfolio change effects, and to recall the underlying policy objectives. Variation margin (VM) requirements are based on a CCP's analysis and driven by market moves, hence, VM effects are particularly pronounced during times of market turbulences. It is critically important for CCPs to collect VM on a daily basis, even intraday, as needed, to prevent an accumulation of losses and under-collateralization due to uncovered exposures. In doing so, CCPs fulfil key policy objectives which have been clearly set out in the applicable regulations. Increases in initial margin (IM), which this consultation focuses on, result from margin parameter changes (increases) in the CCP's margin model. As there are multiple drivers to margin increases, it is important to understand them in isolation.

Therefore, we would like to underline the importance of product-level back-testing and a data driven, outcomes-based approach to setting policy goals around APC.

In this context, we generally appreciate the international standard setting bodies and ESMA's efforts in continuously improving existing standards. While global work is still ongoing, the current ESMA review of the APC tools is implying more prescriptive requirements with a view to increasing convergence among EU CCPs. It is not evident from the Consultation Paper, however, why further convergence within the EU would be beneficial. It is important to note as well that already the existing APC standards for EU CCPs have no equivalent in other jurisdictions ultimately resulting in an unlevel playing field for EU CCPs. We would therefore like to encourage ESMA to ensure consistency with the global work and as mentioned above, we would generally recommend a data-driven, outcomes-based approach to APC as part of CPMI-IOSCO's initiative rather than unilateral moves by the EU. A global alignment on the definition and measures of procyclicality as well as clear policy goals in context of those measures would be the most useful approach to achieve truly comparable outcomes.

Further, we would also like to highlight the absence of APC requirements in non-centrally cleared markets and the scarcity of analysis with regard non-centrally cleared margin models. We appreciate that the joint BCBS-CPMI-IOSCO working group's ongoing assessment of margining practices covers both centrally and non-centrally cleared markets notwithstanding that the analysis of non-centrally cleared markets presented in the Consultative Report is relatively limited. Regulatory standards towards margining should be developed as part of a broader regulatory policy which should consistently cover both centrally cleared and non-centrally cleared markets. A joint development of policies around clearing and the non-cleared world would help to set cohesive incentives structures and prevent unintended outcomes where only one part is addressed or both parts are addressed with gaps or inconsistently.

Catering for a globally coordinated approach, we would encourage ESMA to define the quantitative metrics it would like CCPs to use in order to measure the procyclicality of its models. This would be less intrusive into the operations of CCPs than further specifications related to APC governance or APC tools and at the same time would empower regulators and market participants (when combined with transparency requirements) to make informed assessments about differences in procyclicality of CCPs' models. By adopting clear guidance on quantitative metrics within the EU, ESMA could lay the groundwork to build consensus within global standard-setting bodies around APC. Finally, such guidance on quantitative metrics could also serve to make more informed decisions regarding the recognition of third country CCPs.

Regarding the questions raised in the Consultation Paper, we note that ESMA's quantitative analysis, e.g. in terms of the products, risk factors and models covered,

may not be sufficiently broad to support the rather wide-reaching amendments proposed in the context of the review of the RTS.

While we generally refer to the respective responses for our assessment of the proposals, we would particularly highlight our concerns regarding the APC tools under Art. 28(1)(b) and (c). Some proposals explicitly mandate (historical) or call for (hypothetical) inclusion of stress testing scenarios in margining in the proposed text for Art. 28(1) options b and c. Given that stress testing aims to capture extreme but plausible scenarios at much higher confidence levels than margining, such a move would effectively lead to a permanent increase of minimum confidence levels above the explicit values specified in either EMIR Art. 41 or RTS Art. 24 (Percentage). CCPs would not be able to mitigate this impact as the proposals explicitly require CCPs to avoid the scaling of such stress testing measures e.g. using long term metrics such as through-the-cycle volatility.

It also needs to be considered that EMIR requires CCP to include periods of stress in the margin calculation. Regarding the impact of ESMA's proposals, the consultation paper states under paragraph 80 that in margining only the 99<sup>th</sup> percentile is calculated rather than worst loss as is the case in stress testing. However, ESMA does not appear to consider the fact that stress testing scenarios are pre-selected to be the most extreme scenarios in history and thus calculating e.g. a 99<sup>th</sup> percentile on a small set of pre-selected most extreme historical scenarios will result in an effective confidence well in exceedance of 99%.

In our view, such a major policy amendment with a potentially significant effect on market participants and CCPs should not be adopted by means of a delegated regulation but rather under Level 1 legislation. Beyond the question of consistency with the overarching Level 1 legislation, such a policy change should be thoroughly assessed for any market or competitiveness impacts, especially in light of the European Commission's policy objective to improve the competitiveness of EU CCPs. We discuss the details of the mechanics leading to permanent confidence level uplift in our responses to specific provisions of points (b) and (c).

We trust that our comments are seen as a useful contribution to ESMA's current work around APC and remain at ESMA's proposal for any questions or further feedback.

<ESMA\_COMMENT\_APC\_00>

## Questions

Q1 : Do you agree that CCPs should be able to explain and justify their APC tool choices?

<ESMA\_QUESTION\_APC\_01>

We generally agree that CCPs should be able to explain the choice of their APC tool to regulators. While we welcome that ESMA clearly states in paragraph 36 of the Consultation Paper that CCPs will not be required to perform modelling and comparisons of the different APC tools when selecting or reviewing their APC measures, the wording “justification and related validation approach behind the choice of one of the options” in the draft RTS is not entirely clear. We would appreciate, if ESMA could confirm that a qualitative assessment by the CCP is sufficient to comply with this requirement. Furthermore, we do not see a direct link between the CCPs membership structure and the choice of an APC tool. Therefore, we would appreciate, if ESMA could either clarify the assessment of the suitability of an APC tool for the characteristics of the CCPs’ membership structure, or, delete the requirement to take into account this criterion.

<ESMA\_QUESTION\_APC\_01>

Q2 : 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?

<ESMA\_QUESTION\_APC\_02>

We agree that CCPs should define their own APC thresholds for acceptable margin changes. We also agree with the explicit requirement to involve the risk committee in setting or reviewing APC policies.

Nevertheless, we would highlight that there may be a trade-off between the latter requirement and ESMA’s broader objective to promote convergence in the application of APC tools across CCPs.

Against this background of conflicting objectives, we would refer to our introductory comments questioning the rationale for promoting convergence on the use of APC tool and stressing the importance of a global outcomes-based standard on procyclicality. If ESMA could provide clear guidance for APC policies based on a globally agreed definition of procyclicality and common APC metrics, CCPs could, in collaboration with their respective risk committees, work towards achieving truly comparable outcomes.

<ESMA\_QUESTION\_APC\_02>

Q3: 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?

<ESMA\_QUESTION\_APC\_03>

We broadly agree with the provisions of the new Article 28a. With respect to quantitative metrics, please refer to our response to Question 4.

<ESMA\_QUESTION\_APC\_03>

Q4: Do you agree with ESMA's proposed amendment to require CCPs to assess margins based on quantitative metrics in the context of procyclicality?

<ESMA\_QUESTION\_APC\_04>

We broadly agree with the proposed amendment. Nonetheless, in keeping with our introductory comments and our response to Question 2, we note that the new Article 28a does not provide for a harmonisation of the quantitative metrics to measure procyclicality. The lack of regulatory guidance on the metrics to measure procyclicality leads to a number of drawbacks, e.g. limited comparability of CCP reporting and disclosures. In our view, it would be more sensible to unify the underlying procyclicality metrics rather than adopting more prescriptive and operationally burdensome provisions on the APC tools themselves.

We would encourage ESMA to define the quantitative metrics it would like CCPs to use in order to measure the procyclicality of its models. This would be less intrusive into the operations of CCPs than amending the prescriptive rules of Art. 28(1) and at the same time would empower regulators and market participants (when combined with transparency requirements) to make informed assessments about differences in procyclicality of CCPs' models. Furthermore, by adopting clear guidance on quantitative metrics within the EU, ESMA could lay the groundwork to build consensus within global standard-setting bodies around APC. Finally, such guidance on quantitative metrics could also serve to make more informed decisions regarding the recognition of third country CCPs.

<ESMA\_QUESTION\_APC\_04>

Q5: Do you agree with ESMA's proposal to introduce these three dimensions? Should these be mandatory or optional? How do these compare to the quantitative metrics that CCPs currently consider in practice?

<ESMA\_QUESTION\_APC\_05>



The introduction of three dimensions of assessment of APC measures may be complicating the discussion as only one of the dimensions is directly related to procyclicality of margin models. As per our answer to Question 4, we would encourage more harmonisation in terms of measurement of margin procyclicality which could extend to all European CCPs as well as CCPs operating in the EU under third country equivalence. Ideally, those measures would also be adopted in global guidelines by CPMI-IOSCO.

With respect to the formulation of Art. 28a(1)(c), we consider a reference to margin “dynamics”, emphasizing relative change as opposed to absolute amounts, to be more appropriate than the term “level”.

<ESMA\_QUESTION\_APC\_05>

Q6: 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?

<ESMA\_QUESTION\_APC\_06>

We strongly disagree. It would be more appropriate to separate the assessment of margin model procyclicality from any analysis of effects of changes in price or yield levels. A requirement to perform the procyclicality assessment across different price/yield levels would be extremely cumbersome to implement for CCPs, in particular CCPs who clear a broad range of products, while offering little in the way of insights on the behaviour of margin models. Furthermore, such a requirement would also fail to take into account the characteristics of the respective APC tools. While generally burdensome, the requirement would be more attuned to certain APC tools than others, e.g. the 25% weight on stressed observations which is already based on a more modular design.

In line with our previous answers, we would instead encourage ESMA to come up with model procyclicality measurement tools that correct for the effects induced by factors other than margin model itself, e.g. drift in market price which might have profound effects over time, especially for products with non-linear payoffs.

<ESMA\_QUESTION\_APC\_06>

Q7: 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?

<ESMA\_QUESTION\_APC\_07>

We generally agree with the proposal but would appreciate more guidance on the materiality criterion from a regulatory perspective. The proposed definition coupled with the non-exhaustive list of risk factors in Article 28(2) of the amended RTS will

not allow for a clear distinction between non-material and material risk factors which results in a regulatory uncertainty for CCPs.

<ESMA\_QUESTION\_APC\_07>

Q8: 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?

<ESMA\_QUESTION\_APC\_08>

We agree with this proposal but similar to Question 7 we would seek further guidance as to what means of consideration ESMA would expect in order to achieve compliance.

<ESMA\_QUESTION\_APC\_08>

Q9: Do you agree with ESMA's proposal on how to apply the APC options for different risk factors?

<ESMA\_QUESTION\_APC\_09>

We agree with ESMA's proposal to allow CCPs to either use different options for different risk factors, or apply the same option across all risk factors by applying the measure independently to each risk factor or by using internally consistent scenarios across risk factors to be applied at product or portfolio level.

However, we are concerned that this provision in conjunction with the requirement to justify the choice of the APC tool (Question 1) could potentially give rise to the interpretation that CCPs are required to justify the choice of an APC tool at risk factor level. We would not agree with a requirement to assess the suitability of an APC tool to a specific risk factor because it would create an unreasonable burden on the CCP while unnecessarily limiting the discretion of the CCP risk management function.

<ESMA\_QUESTION\_APC\_09>

Q10: 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?

<ESMA\_QUESTION\_APC\_10>

We broadly agree with this proposal. Further regulatory guidance on certain aspects of the policies and procedures, e.g. how to set the parameters to determine when margin requirements are rising significantly and when an exhaustion of the margin

buffer may be warranted, and under what conditions the buffer should be replenished following an exhaustion, would be helpful.

<ESMA\_QUESTION\_APC\_10>

Q11: 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?

<ESMA\_QUESTION\_APC\_11>

We generally agree on the need for discretion by CCPs as opposed to a requirement to automatically activate a buffer in case a predefined threshold is reached. Nevertheless, as referred to in our previous response, more guidance on the setting of thresholds for potential use of the buffer would be appreciated.

<ESMA\_QUESTION\_APC\_11>

Q12: 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?

<ESMA\_QUESTION\_APC\_12>

It could be difficult for a CCP to develop a quantitative assessment framework to assess the need for a higher buffer. This is, in part, due to the methodological limitations of the 25% value itself which is not linked to an overarching procyclicality measure or related policy objective (see introductory comments). Further guidance on clear and measurable policy goals as well as best practices on the approaches to review the appropriateness of the 25% minimum buffer would thus be helpful.

<ESMA\_QUESTION\_APC\_12>

Q13: Are there cases where ESMA's proposal to modify Article 28(1)(a) RTS would present difficulties for CCPs in practice?

<ESMA\_QUESTION\_APC\_13>

We would refer to our previous responses describing the challenges around the justification of the need for a higher buffer in relation to the CCPs' products and margin model.

<ESMA\_QUESTION\_APC\_13>

Q14: Do you agree that CCPs should consider the extreme market movements from the historical stress scenarios identified under Article 30 of the RTS?

<ESMA\_QUESTION\_APC\_14>

Unlike the question (“consider”), the wording of the draft RTS implies that CCPs would be obliged to include such movements. We would not agree with such a requirement, if intended by ESMA.

In a complex setting of CCP risk management frameworks, CCPs should be able to use different tools for different purposes. Whereas stress tests examine a CCP’s resilience against outsized moves in the market and its ability to continue operations in such circumstances, the role of margining is to protect against the portfolio’s underperformance due to market moves. Therefore, the use of the extreme market movements from the historical (or hypothetical) stress scenarios under Article 30 of the RTS will not be appropriate scenarios for the purposes of margining given the selection of stress scenarios is performed with a different goal in mind.

It is entirely appropriate for an APC tool to limit the decrease in margin requirements when market volatility falls to below its long-term average to avoid excessive increases. This may be achieved through the use of margin floors, volatility floors or by mixing the short term with stress component. The end result, however, should be that margins in a low volatility environment are driven by the long-term, through-the-cycle volatility and reflect 99% confidence calculated by incorporating both periods of low and high volatility.

By way of contrast, ESMA’s proposals would have wider-reaching effects that go beyond ensuring that the APC tool fulfils its above described purpose. By requiring the CCPs to include the historical stress testing scenarios, ESMA is effectively shifting the confidence level of the model upwards.

As a simple example, one could consider the typical lookback period for historical stress testing which may entail the past 30 years or approximately 7500 observations. As CCPs select a relevant set of historical stress testing scenarios, they choose historical days with most extreme moves. One could assume for our purposes that the CCPs chose the 25 largest falls and the 25 largest gains in the past 30 years. This means that for a given position, the set of historical stress scenarios would contain the top 0.33% most extreme moves. In addition, the draft RTS would require CCPs to apply the standard confidence level parameter for that set of scenarios (99%) while at the same time disallowing any scaling to bring the effective confidence level down (e.g. scaling to bring effective confidence level down to 99% calculated over the entire 30 year period).

Calculating 99% over a subset of most extreme 25 moves from 7500 observations would result in confidence level jumping up to  $1 - 0.33 * 0.01 = 99.97\%$  for this component. Thus, although the Consultation Paper points out under paragraph 80 that CCPs would only be expected to calculate the same confidence level as in margining and not worst loss as per stress testing, we conclude that the effective confidence level of the procedure (99.97% as exemplified with the calculation above) will indeed be higher than under margining rules.

It is important to mention that Art. 28(1)(b) only calls for 25% of the margin to be calculated this way. Hence, we are not suggesting that the margin requirements will move completely to the stress testing level, but already achieving a mix of 75% of margin requirements at 99% and 25% of margin requirements at near-100% confidence will significantly increase through-the-cycle confidence level of the margins in European CCPs applying this method. This raises questions both in the context of whether such technical standard would remain consistent with Art. 41 EMIR as well as in the context of global competitiveness of clearing in the EU. From a global perspective, it should also be noted that the CPMI-IOSCO Principles for financial market infrastructures only require a confidence level of at least 99 percent.

<ESMA\_QUESTION\_APC\_14>

Q15: 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)?

<ESMA\_QUESTION\_APC\_15>

Please refer to our response to the previous question. While the wording for hypothetical stress scenarios is less prescriptive than for historical scenarios and only calls for consideration, the problems raised in the previous questions remain applicable here.

<ESMA\_QUESTION\_APC\_15>

Q16: 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?

<ESMA\_QUESTION\_APC\_16>

We strongly disagree. The formulation of this paragraph appears to call for two contradictory objectives. Either CCPs should ensure the set of extreme market movements is adequate for the products that could expose it to the greatest financial risks or for all margined products. In our view, CCPs should focus on the products which may expose the CCP to the greatest financial risk. Covering all margined products would be extremely burdensome for CCPs while also not being justified from a procyclicality risk perspective.

As a matter of example, Eurex Clearing clears more than 2500 listed products and its risk model uses tens of thousands of risk factors. If Eurex Clearing were required to include scenarios which are extreme for all of the margined products, this would simply result in all scenarios being selected as each scenario will be, in its own way extreme to either a single product or a potential combination of products. This

dilution of a set of stress periods with periods that are not material from the perspective of greatest financial risks would undermine the potency and focus of the concept. Lastly, due to the proposed linkage to Art. 30 (separately covered in previous questions), this concept may actually feed back to quality of scenario selection for stress testing which notably fulfils a different role in the CCP risk frameworks.

<ESMA\_QUESTION\_APC\_16>

Q17: 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?

<ESMA\_QUESTION\_APC\_17>

We appreciate that ESMA addresses the existing regulatory timeframes for the review of extreme scenarios as well as the applicable provisions for extraordinary or material changes when required.

We are not aware of any evidence indicating that a requirement for a more frequent review would be needed for the purposes of the APC tool. Adding a provision to 'consider' a more frequent review appears less prescriptive than an outright requirement but will likely create an additional burden for the CCPs. In practice, CCPs may – under challenging circumstances - have to devote many resources to analyse, discuss and demonstrate that consideration with regulators in order to ensure compliance.

Given that the minimum lookback in Art. 25 is one year and thus stress observations will not drop out of the lookback window of ordinary margin before then, annual review cycle is perfectly adequate for APC measures.

<ESMA\_QUESTION\_APC\_17>

Q18: 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?

<ESMA\_QUESTION\_APC\_18>

While we agree with the spirit of the proposal, the confidence level requirement, when combined with linkage to stress testing scenarios, which are already pre-selected as the most extreme scenarios over a very long lookback, elevates the confidence level of this component to nearly 100% (as explained in our response to Question 14). This would result in overall margin requirements (ordinary margin elements plus APC tools) substantially exceeding the confidence level set out in Art.

41 of EMIR - not only at times of extraordinarily low volatility but through the entire economic cycle.

<ESMA\_QUESTION\_APC\_18>

Q19: 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?

<ESMA\_QUESTION\_APC\_19>

We disagree with the proposal for the reasons outlined in answer to Question 14.

We would also recall that stress testing and margining have different objectives: While margin is calculated on client level (gross), the stress test is performed on the clearing member level (net considering the segregation models used by clients). A stressed margin on client level (gross) is therefore not necessarily relevant for calculating the required total financial resources of the CCP.

Instead, APC measures should ensure that short term margins do not fall below the confidence level (respectively long-term volatility) calculated over a long period of time incorporating the entire economic cycle, e.g., 10 years or longer, if required.

<ESMA\_QUESTION\_APC\_19>

Q20: 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?

<ESMA\_QUESTION\_APC\_20>

We note that ESMA proposes for the first time to require CCPs to calculate the margin as a combination of 75% of unadjusted margin and 25% of stress margin. This is a significant change compared to the current RTS which merely refer to 25% of stressed observations and are thus less specific on the way the two components are to be mixed.

The rationale for this restriction on the allowable model set is not clear based on the evidence presented in the Consultation Paper. In this context, we would reiterate our view that APC tool provisions are most effective when focusing on the objective of limiting the pace of margin increases. Additional specifications or constraints might weaken the efficacy of this tool at the time when it needs to provide the much-needed cushioning.

<ESMA\_QUESTION\_APC\_20>

Q21: Are there cases where ESMA's proposal to modify Article 28(1)(b) RTS would present difficulties for CCPs in practice?

<ESMA\_QUESTION\_APC\_21>

As per the answer to Question 14, the main impact is effective uplift in through-the-cycle confidence level beyond the 99% specified in EMIR Art. 41. At present, the EU APC RTS and Guidelines are not replicated in many third party jurisdictions. Therefore, the proposal may negatively affect ongoing competitiveness of EU central clearing.

In addition, the significant changes to the provisions of Art. 28(1)(b) would generate a high operational effort for CCPs. Therefore, a long implementation period would be needed. CCPs would need to commission model development activities followed by model validation, internal governance and would then need to request regulatory approval of significant model changes at European level under the EMIR Art. 49 procedure. These regulatory costs and impacts should be offset by clear and demonstrable benefits of changing the existing provisions.

<ESMA\_QUESTION\_APC\_21>

Q22: Do you agree with ESMA's proposal that the margin floor should include stress market movements in addition to the 10-year lookback period? Do you agree with the methodology used to identify these extreme market movements?

<ESMA\_QUESTION\_APC\_22>

We do not agree with ESMA's proposal. While we note ESMA's intention to resolve the issue of the 2008 (sub-primes) stress market movements dropping off 10-year lookback periods, we would call for a more proportionate and methodologically robust approach to achieve that objective.

As also stated in our previous responses regarding the revised Art. 28(1)(b), we do not see a clear methodological rationale behind the introduction of stress testing scenarios to the calculation. The proposal would effectively elevate the through-the-cycle confidence level above the value specified under EMIR Art. 41. Unlike the current wording of Art. 28(1)(c) RTS referring to "volatility", the proposal uses the term "margin floor". This amendment would effectively restrict the set of possible implementation options for CCPs and require a separate margin calculation (while excluding the flooring of a volatility parameter of the model).

Under a 10 year historical lookback period (or 15 years, in case no significant stress events, e.g. Covid-19 crisis, occur in the meantime) CCPs would calculate 99<sup>th</sup> percentile over a long period of time, which would be methodologically sound as the margin floor would be set in line with through-the-cycle volatility.



One could conceive the following practical scenario: under the proposed amended RTS, one would expect the floor to be a combination of 10 years of history plus stress testing scenarios. One could start with a 10 year lookback period (2500 observations) which may or may not include crisis period(s). Whether or not it includes stress will vary – in 2019 it would not include the 2008 (sub-prime) crisis, whereas in early 2029, it will include at least both the fallout from Covid-19 in March 2020 and the war in Ukraine, and potentially other crises in the next seven years. One could thus, for the sake of simplicity, distinguish two scenarios: the ‘2019 scenario’ (without stress periods at all) and the ‘2029 scenario’ which will include stress periods on average every three years. One would then add the 25 most extreme scenarios selected over the past 30 years as an example of a typical set of historical stress scenarios. One would also assume that the CCP considered and decided against the inclusion of hypothetical (future) scenarios in accordance with the proposed draft RTS.

In the ‘2019 scenario’, the CCP would include 2500 observations (without stress periods) plus 25 extreme moves. It would calculate the 99<sup>th</sup> percentile which would fall just behind the last stress testing observation. Hence, the CCP’s margin floor would be driven by an observation from this period of prolonged low volatility. Under this scenario, the gap identified by ESMA with respect to stress periods would not be closed. Moreover, the CCP could ‘steer’ the level of margin floor simply by identifying fewer stress testing scenarios. Thus, there is a concern that ESMA’s proposal may create opportunities for regulatory arbitrage.

Under the ‘2029 scenario’, the CCP would have 2500 observations. 50 out of these 2500 observations would reflect markets in various forms of stress (e.g. Covid-19, Ukraine and potential future shocks). The CCP would combine this set with 25 further extreme scenarios gathered from stress testing and calculate the 99<sup>th</sup> percentile. As a result, the entire tail of this lookback period would abound in extreme observations. The 99<sup>th</sup> percentile picks 25<sup>th</sup> most extreme out of 75 stress events and the margin floor would increase significantly. To conclude, the margin floor would be overly high in a ‘2029 scenario’ where the 10 year lookback without an additional set of extreme market movements would clearly have sufficed.

Based on the above, we would argue that a more comprehensive impact analysis should be carried out prior to the adoption of ESMA’s proposal in order to ensure that the regulatory objectives are met and any unintended effects are avoided.

As a viable alternative, we would suggest a targeted amendment to the existing wording which may better serve the test of time when the 2008 (sub-prime) crisis becomes just one of a series of crises in the lookback period.

As an example, the following additional language could be introduced to the current RTS: *“The margin floor should be calculated on the basis of a sufficient lookback which captures the full spectrum of market behaviour, including periods of stress, but in no case should be shorter than 10 years. The CCP should demonstrate to its competent authority that its chosen lookback period includes periods of stress.”* Such an amendment would be more proportionate in relation to the impact on the

CCP and would better address ESMA's concerns with just having a 10-year fixed requirement in the existing RTS.

<ESMA\_QUESTION\_APC\_22>

Q23: Do you agree that the margin floor should be calculated in compliance with Articles 24, 26 and 27 of the RTS?

<ESMA\_QUESTION\_APC\_23>

We agree with this premise but disagree with rest of the proposal as per our answer to Question 22.

<ESMA\_QUESTION\_APC\_23>

Q24: Do you agree that the margin floor should be recomputed at the same frequency than the baseline margin requirements?

<ESMA\_QUESTION\_APC\_24>

While it would be beneficial for margin floor to be recomputed at the same frequency, we would want to draw attention to the cost-benefit analysis associated with that.

Calculating margin on the lookback period involves at least 2500 scenarios (or more, if ESMA decides to require the addition of stress testing scenarios as proposed in the Consultation paper, or if the lookback period were extended to include the 2008 sub-prime crisis). As the minimum lookback standard for unadjusted margin is 1 year or approximately 250 scenarios, the APC measure requires approximately 10 times the number of computations as the unadjusted margin. Assuming that the CCP runs state-of-the-art near to real time margining, this may present significant implementation challenges. Furthermore, such amount of data may be overwhelming for any members or clients who aim to replicate CCP margins with a view to ensuring liquidity preparedness, and who would need to consume all those scenarios for potentially more than 100,000 instruments.

On the other hand, the practical benefits of such a requirement, in terms of improving risk management, would be limited. Because of the large number of observations in the lookback period, the risk measure tends to be stable for longer as additional datapoints are less likely to materially influence it. The same cannot be said for unadjusted margins which typically have shorter lookback periods and thus are more prone to quickly react to new data points.

In conclusion, the benefits of such a requirement are far outweighed by the drawbacks. It may negatively affect the global competitiveness of EU CCPs without resulting in noticeable improvement of risk management practices.

<ESMA\_QUESTION\_APC\_24>

Q25 : 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?

<ESMA\_QUESTION\_APC\_25>

We disagree with the premise of the ESMA proposal as outlined in our answer to Question 22.

<ESMA\_QUESTION\_APC\_25>

Q26 : Are there cases where ESMA's proposal to modify Article 28(1)(c) RTS would present difficulties for CCPs in practice?

<ESMA\_QUESTION\_APC\_26>

As per the answer to Question 22, the main impact is effective uplift in through-the-cycle confidence level beyond the 99% under EMIR Art. 41. Furthermore, due to the arbitrage risk also described in our answer to Question 22, the proposal could potentially reduce the quality of existing risk management processes around stress testing.

Finally, the significant changes to the provisions of Art. 28(1)(c) would generate a high operational effort for CCPs. Therefore, a long implementation period would be needed. CCPs would need to commission model development activities followed by model validation, internal governance and would then need to request regulatory approval of significant model changes at European level under the EMIR Art. 49 procedure. These regulatory costs and impacts should be offset by clear and demonstrable benefits of changing the existing provisions.

<ESMA\_QUESTION\_APC\_26>